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Overview of the economic and social conditions in Africa 2007

Summary

This report reviews the economic and social conditions in Africa for 2006 and presents an outlook for medium-term developments and prospects for growth in 2007. Overall, the report shows that economic growth has continued to improve in 2006, reaching 5.7 per cent compared to 5.3 per cent in 2005. It argues that those positive results could be attributed to good macroeconomic management, strong demand for and higher prices of primary commodities, debt relief, increased external capital flows and an improved political climate. However, a key message of the report is that improvements in social development lag significantly behind improvements in economic performance. The report concludes with a set of policy recommendations aimed at accelerating and sustaining growth in African countries as a means of reducing poverty and achieving the Millennium Development Goals.

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I. The global economy

1. Growth in the world economy remains moderate although it improved slightly in 2006 relative to 2005 (from 3.5 per cent to 3.8 per cent). The growth was driven by the strong performance of the Asian economies, which continue to post growth rates above 8 per cent. In contrast, growth in advanced economies remains modest and is yet to reach the pre-2001 level. Key constraints to growth include massive global macroeconomic imbalances along with tighter macroeconomic stances in advanced economies, which prevent demand-led recovery. In addition, high oil prices have undermined growth in both advanced and developing countries through high production costs.

2. Increasing current account, government, and private sector deficits in industrial countries, especially in the United States of America, threaten domestic economic recovery as well as global financial stability. Widening deficits in the United States have been financed mainly by savings in the developing world, especially in Asia and Latin America. Correction of these global macroeconomic imbalances requires concerted and coordinated efforts in industrialized economies and the developing world. The adjustment mechanism will involve an increase in savings in the United States and an increase in investment in other countries, as well as depreciation of the United States dollar, which will allow adjustment of the United States trade deficit and reduce incentives for developing countries to accumulate reserves.

3. Positive global economic developments in 2006 that are likely to sustain growth in Africa include high export commodity prices due to high demand, especially from Asia, delivery of promised aid and debt relief, rising inflows of foreign direct investment (FDI) with an increasing share coming from China and India, and higher inflows of worker remittances. These developments need to be supported, however, by adequate domestic policies in order to maximize their impact on growth in Africa.

4. Overall, the medium-term outlook for the world economy remains upbeat and a soft landing for the United States seems likely. In addition, global imbalances have started to stabilize, although they remain large. For African countries, however, there remain some risks arising from competition from Asia and the weakening of housing markets in advanced economies, which could reduce demand and weaken commodity prices. Economic diversification, increased domestic demand and regional integration are crucial in order for African countries to increase their exports, reduce vulnerability to external shocks and ultimately sustain the recent growth recovery.

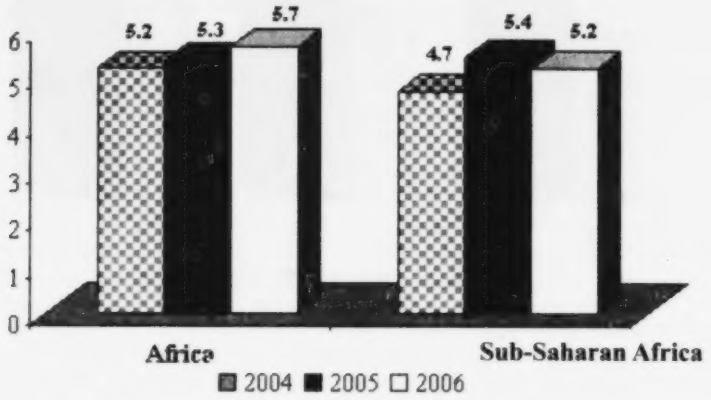
II. Overall growth performance in Africa

A. African economies continue to sustain the growth momentum

5. African economies continued to sustain the growth momentum of previous years, recording an overall real growth rate of gross domestic product (GDP) of 5.7 per cent in 2006, compared to 5.3 per cent in 2005 and 5.2 per cent in 2004 (figure 1). Twenty-eight countries recorded improvements in growth in 2006 relative to 2005. Only one country, Zimbabwe, recorded a negative growth rate in 2006. Africa's growth performance in 2006, as in previous years, was underpinned by

improvement in macroeconomic management in many countries and strong global demand for key African export commodities, resulting in high export prices, especially for crude oil, metals and minerals.

Figure 1
Real growth rate of gross domestic product in Africa, 2004-2006 (percentage)



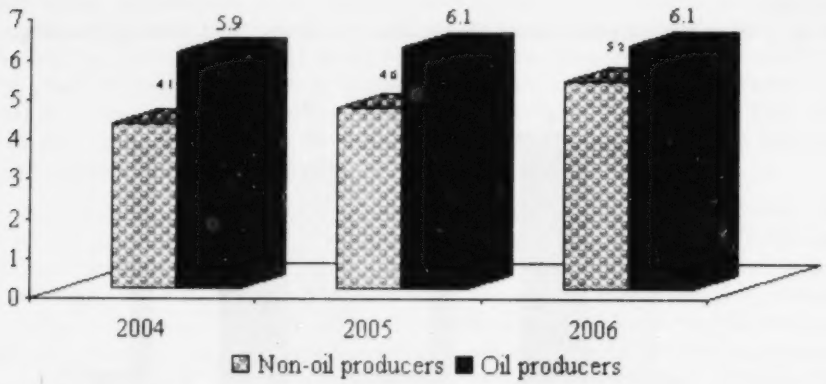
Source: Economist Intelligence Unit, 2007.

6. The growth impact of commodity prices was particularly strong for oil-exporting countries. These countries as a group contributed 57.5 per cent of the continent's 5.7 per cent growth rate in 2006, compared to 53.4 per cent in 2005. The recent increase in oil prices has increased the dominance of oil producers in the continent's overall growth, overshadowing the improvements observed among non-oil countries (from 4.6 per cent in 2005 to 5.2 per cent in 2006) (figure 2). Efficient management of oil revenues and economic diversification are essential in order for oil-exporting African economies to reduce vulnerability to oil price shocks, ensure that gains from oil revenue are broadly shared and achieve sustainable growth.

7. In addition to increased aid flows and debt reduction, improved economic management and increases in non-oil commodity prices have more than offset the negative impact of high oil prices on the real GDP of African oil importers. On average, these countries maintained a positive and rising real GDP growth rate during 2004-2006. The growth impact of higher oil prices was particularly moderate for non-oil non-mineral-rich economies, where growth performance improved from 4.1 per cent in 2005 to 5.8 per cent in 2006 (figure 3), thanks to debt relief and increased aid flows, as well as improved agricultural performance and high agricultural commodity prices. The growth rate in non-oil mineral-rich African countries was almost unchanged in 2006 relative to 2005, as the effects of rising oil prices dampened the gains from higher prices of minerals.[1]

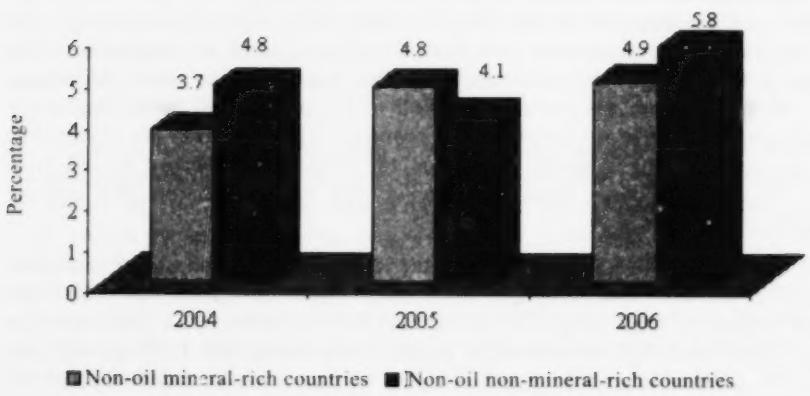
[1] Oil-importing African countries need to reduce their dependence on oil by making use of alternative sources of energy, especially hydropower, and by adopting strategies to rationalize the use of oil and improve the efficiency of their energy systems. This is crucial not only because of high oil prices, but also because of the relatively high-energy intensity of GDP in these countries (Energy Sector Management Assistance Program, 2005).

Figure 2
Real growth gross domestic product in African oil versus non-oil economies, 2004-2006 (percentage)



Source: Economist Intelligence Unit, 2007.

Figure 3
Growth in mineral-rich countries versus non-oil non-mineral-rich countries (percentage)



Source: Economist Intelligence Unit, 2007.

B. Oil-importing African countries are affected by high oil prices

8. Oil-importing countries will suffer severe adverse effects if higher oil prices persist in the medium-term (see box). To minimize the effects of high oil prices on inflation and macroeconomic stability in general, African Governments need to pursue prudent policies, especially by avoiding monetization of deficits. In the meantime, the international donor community and international financial institutions should provide special support to oil-importing low-income African countries in

order to mitigate the impact of higher oil prices. In particular, debt relief and additional non-debt-generating external financing of fiscal deficits are critically needed to assist African oil-importing countries to sustain economic growth and achieve the Millennium Development Goals.

Box:

Sustained higher oil prices will slow down growth and weaken progress towards the Millennium Development Goals in low-income oil-importing African countries

Oil-importing African countries are characterized by high oil-intensity of primary energy sources and inelastic oil demand. Higher oil prices raise production costs, leading to lower output as well as tighter financial constraints. Governments are forced to decrease expenditures on infrastructure and social services in order to finance the higher oil bill. Moreover, higher oil prices fuel domestic inflation, increase fiscal deficits and worsen the balance of payments position as well as the terms of trade. This can undermine economic performance both directly and indirectly through increased uncertainty.

Although oil-importing African countries have recorded positive overall GDP growth in the past few years, they are experiencing mounting internal and external imbalances. Strong commodity demand, good macroeconomic management, better agricultural performance, improved political governance in many countries and increased aid flows and debt relief are the key factors that have helped them to maintain overall growth momentum. However, as a result of the recent hike in oil prices, the share of fuel imports in merchandise imports of the oil-importing African countries have risen significantly, leading to notable increases in the current account deficit. Moreover, oil-importing countries have sustained large terms of trade losses.

Mounting budget deficits and inflationary pressures in oil-importing African countries will disproportionately affect the poor because of lower employment prospects and lack of safety nets. Budget constraints may also force Governments to introduce user fees for social services and to raise prices of public utilities such as electricity and water.

The critical challenge for oil-importing African countries is to reduce their dependence on oil by promoting alternative sources of energy. It is particularly critical for these Governments to strengthen growth policies, including industrial strategies that promote diversification of production and exports. The international donor community and international financial institutions should provide special support to oil-importing African countries in order to mitigate the impact of higher oil prices. In particular, debt relief and additional non-debt-generating external financing are critical to allow these countries to sustain economic growth and accelerate progress towards the Millennium Development Goals.

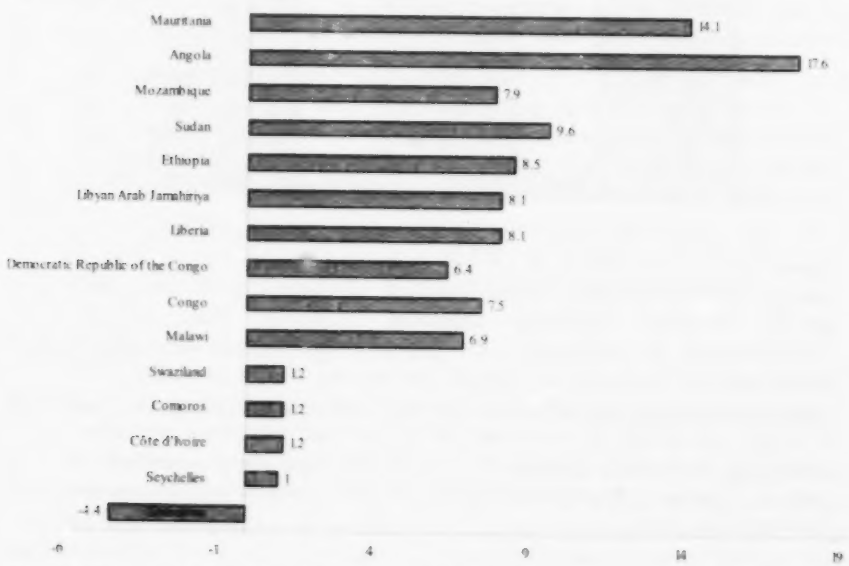
Source: Economic Commission for Africa, 2006a.

1. Uneven growth with stagnation at the bottom of the scale

9. The overall strong growth performance conceals wide disparities across economies continent-wide, characterized by stagnation at the bottom of the scale. Only three countries (Angola, Mozambique and the Sudan) of the top 10 performers in 2006 were among the top 10 performers on the basis of average annual growth rates during 1998-2005 (ECA, 2006b) and half of the top 10 performers are oil producers (Angola, the Libyan Arab Jamahiriya, Mauritania, the Congo and the Sudan). Of the remaining five top performers, two are mineral-rich countries (the Democratic Republic of the Congo and Mozambique) and one (Liberia) is a post-conflict country (figure 4). High oil and mineral prices were the main growth drivers for the best performing countries.

10. Five countries (the Comoros, Côte d'Ivoire, Seychelles, Swaziland and Zimbabwe) have the lowest growth rates over 1998-2006. Swaziland's growth performance has weakened over the last five years owing to increasing competition and falling prices in the textile export market and the reduced sugar price in the European Union (EU) market. The Comoros, which is heavily dependent on agriculture, continued to experience low growth due to low revenue from vanilla exports and a decline in the tourism sector, while political conflict and insecurity continued to deter investment and undermine economic performance in Côte d'Ivoire. Economic performance in Zimbabwe remained negative in the last eight years owing mainly to political difficulties exacerbated by recurrent droughts. Foreign exchange constraints and the recent rises in oil prices adversely affected investment and capacity utilization in Seychelles, also leading to nearly complete economic stagnation in the last eight years.

Figure 4
Annual growth of the top 10 and bottom 5 performers in Africa in 2006 (percentage)



Source: Economist Intelligence Unit, 2007.

2. Subregional growth performance varies substantially

11. Growth performance exhibits substantial disparities across the five subregions.[2] North Africa recorded the highest acceleration in GDP growth, from 5.2 per cent in 2005 to 6.6 per cent in 2006, followed by Southern Africa, from 5.6 to 5.9 per cent. There was a notable deceleration in growth momentum in West Africa, from 5.4 per cent in 2005 to 4.2 per cent in 2006. Heavy dependence on primary commodities remains a common feature of production, exports and growth in all subregions. This exposes the continent to external shocks and makes economic diversification a top priority for growth policies on the continent.

12. Stronger growth performance in North Africa was mainly the result of higher oil prices, especially for Algeria, the Libyan Arab Jamahiriya, Mauritania and the Sudan. Mauritania achieved the highest increase in GDP growth rate (from 5.4 per cent in 2005 to 19.4 per cent in 2006) owing to the start of commercial exploitation of crude oil in 2006. Steady growth in the secondary and tertiary sectors (especially tourism) continued to boost economic performance in North Africa. Adequate management of oil revenue is needed for the subregion to sustain the growth momentum.

13. Growth in Southern Africa improved in 2006 largely because of economic recovery in Malawi and Lesotho and sustained good performance in most other countries of the subregion. With increased public spending and high FDI flows, South Africa maintained the same growth rate of 2005 through 2006. Notwithstanding the slowdown in oil production, Angola remains the fastest growing economy in Southern Africa (17.6 per cent), followed by Mozambique (7.9 per cent), Malawi (6.9 per cent) and Zambia (6 per cent). Zimbabwe, though still on the negative side (-4.4 per cent in 2006, from –7.1 per cent in 2005), and Malawi recorded the largest improvements in growth, thanks to favourable weather conditions and commodity markets, although recovery from the 2005 drought is still incomplete. Growth in Mauritius also improved considerably, despite stiff competition from Asia in the textile market, thanks to increased investment and notable growth in the service sector. Growth in Lesotho picked up in 2006 owing to increased investment in manufacturing and mining, which has resulted in higher textile and diamond exports. Swaziland continued to record a low growth rate (1.2 per cent) owing to drought and a decline in the textile industry.

14. Growth in Central Africa was underpinned by higher oil prices. In spite of sustained increases in oil prices, Chad and Equatorial Guinea experienced the greatest decline in GDP growth in 2006, followed by the Congo, because of a slowdown in crude oil production. Oil production declined in Chad in 2006 because of technical problems. Cameroon, the Central African Republic and Sao Tome and Príncipe were the only three countries in the subregion with higher growth rates in 2006 than in 2005, thanks to the improved prices for agricultural commodities such as coffee and cocoa.

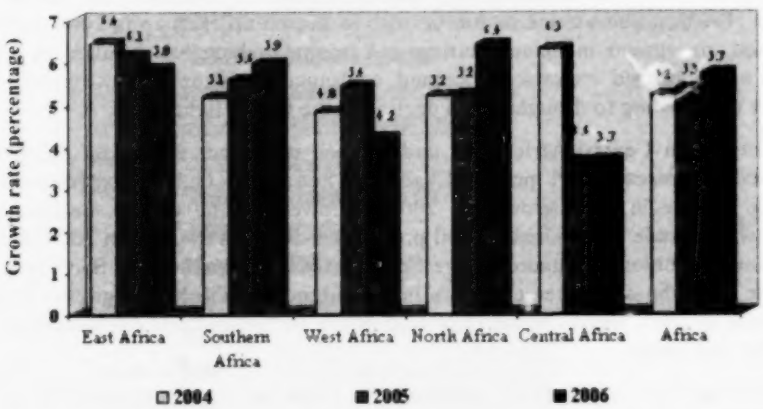
15. In East Africa, weather conditions as well as export commodity prices remained largely favourable despite sporadic drought in the Horn of Africa. East Africa was the best performing subregion in 2004 and 2005 but experienced a slight decline in growth rate in 2006. Higher oil prices were the main factor that prevented the subregion from achieving a higher growth rate, as all the countries of East Africa

[2] Subregional growth rates are calculated using individual country GDP as weights.

are oil importers. Economic performance remained robust in Ethiopia (8.5 per cent), Kenya (5.5 per cent), the United Republic of Tanzania (5.8 per cent), and Uganda (5.0 per cent) owing to higher commodity prices, especially for tea and coffee. Burundi, the Democratic Republic of the Congo and Rwanda achieved higher growth rates in 2006 (7.0, 5.8 and 4.2 per cent, respectively), thanks to growth in construction, trade and manufacturing, as economic activity benefited from the gradual restoration of peace in the region. The mining sector also contributed significantly to growth in the Democratic Republic of the Congo. Economic performance remained low in the Comoros (2.2 per cent), owing to low revenue from vanilla exports and a decline in the tourism sector, and in Eritrea (2.0 per cent), owing to low investment and other adverse effects of border conflicts. Seychelles recorded an improvement in economic performance (from –1.5 per cent in 2005 to 1.0 per cent in 2006) owing to a gradual recovery from the adverse effects of the tsunami of 2005 and the decline in tourism and tuna exports in the previous two years.

16. West Africa experienced the greatest decline in GDP growth in 2006 due to a decline in growth in Nigeria (from 6.0 per cent in 2005 to 4.2 per cent in 2006) as a result of social unrest in the Niger delta. Growth remained low in Côte d'Ivoire (1.2 per cent) owing to political instability, which disrupted agriculture and industry. Among non-oil economies, growth in Senegal (4.0 per cent), though still strong, slowed down because of weaker industrial performance as a consequence of high oil prices and the failure to renew Senegal's fishing accord with the EU.[3] Liberia sustained its strong post-conflict growth recovery. The Gambia achieved a 5.5 per cent growth rate in 2006 compared to 5 per cent in 2005, thanks to good rainfall and increased tourism activity. Growth in other countries in the subregion in 2006 was similar to that of 2005.

Figure 5
Subregional growth performance in 2004-2006



Source: Economist Intelligence Unit, 2007.

[3] Failure to renew Senegal's accord with the EU on fish exports, which ran from July 2002 to June 2006, restricts Senegalese fish exports to the EU and results in US$ 20.2 million loss in annual financial payments to Senegal (Economist Intelligence Unit, 2006a).

III. Sustainability of macroeconomic balances remains a concern over the medium-term

A. Oil as a key factor in fiscal balance improvement

17. Overall, Africa has continued to maintain a positive fiscal position, with the average budget balance (excluding grants) of 0.1 per cent of GDP in 2006 compared to 0.4 per cent in 2005 (table 1). For the 40 countries for which comparable data were available, there was a slight increase in the number of countries having budget deficits in 2006 relative to 2005 (from 27 to 30), owing to increases in oil prices resulting in higher government expenditures in oil-importing countries. Significant increases in public sector investment resulted in sizeable budget deficits in some oil-exporting countries: Angola (-5.0 per cent), Chad (-4.4 per cent), Egypt (-7.9 per cent) and Tunisia (-3.8 per cent).

18. With the exception of Sao Tome and Principe, all the countries that had budget surpluses in 2006 are oil exporters (Algeria, Cameroon, the Congo, Equatorial Guinea, Gabon, the Libyan Arab Jamahiriya and the Sudan). Therefore, oil continues to be the key factor behind the positive fiscal position for Africa as a whole. This raises concern over the sustainability of fiscal balance over the medium term for many oil-importing African countries.

19. Official development assistance (ODA) is a major source of budget support for many of these countries. The dependence of government budgets on oil revenue and external aid constitutes a source of vulnerability of fiscal balance and GDP growth in Africa. For oil producers, fiscal sustainability will require effective strategies for prudential management of oil revenues and strategies to utilize these revenues to enhance economic diversification. Non-oil-exporting African countries need to design mechanisms for increased mobilization and better management of revenue from domestic sources.

Table 1
Distribution of fiscal deficits in Africa, 2004-2006 (number of countries)

	2004		*2005*		*2006*	
	Oil producers	*Non-oil producers*	*Oil producers*	*Non-oil producers*	*Oil producers*	*Non-oil producers*
Countries with surpluses	**6**	**3**	**7**	**6**	**7**	**3**
Less than 5 per cent	2	2	1	4	2	3
5 per cent to 10 per cent	2	1	3	1	0	0
More than 10 per cent	2	0	3	1	5	0
Countries with deficits	**7**	**24**	**6**	**27**	**6**	**24**
Less than 5 per cent	5	18	5	15	5	13
5 per cent to 10 per cent	2	5	1	6	0	9
More than 10 per cent	0	1	0	0	1	2
Total number of countries	**13**	**27**	**13**	**33**	**13**	**27**

Source: Economist Intelligence Unit, 2006b.

B. Pressure from oil prices threatens price stability

20. For the second year, average consumer price inflation increased in Africa (from 8.5 per cent in 2005 to 9.9 per cent in 2006). Inflationary pressure has resulted mainly from higher oil prices and the subsequent increase in production costs and lower output. In most countries, food prices rose significantly, owing to higher transportation costs. While inflation remained contained and low in most of the 53 African countries with available data, the risk of higher inflation remains a concern should higher oil prices persist in the near future.

21. Despite the increase in the average rate of inflation, the situation has improved in 2006 relative to 2005 with more countries having inflation rates of less than 5 per cent, and fewer countries having two-digit inflation (table 2). However, a few countries experienced drastic increases in inflation. In Zimbabwe, inflation increased to 1,216 per cent in 2006 compared to 237.8 per cent in 2005, owing to inflationary finance of the budget deficit and shortage of food, especially maize. In Guinea, the country with the second highest inflation rate in Africa, inflation remained high (27 per cent in 2006 compared to 31.4 per cent in 2005), owing to the effects of high oil prices and imported inflation arising from high imports of consumer goods.

Table 2
Distribution of inflation rates in Africa, 2004-2006 (number of countries)

Range	*2004*	*2005*	*2006*
Less than 5 per cent	30	21	25
Between 5 and 10 per cent (10 per cent excluded)	6	14	15
Between 10 and 20 per cent (20 per cent excluded)	13	13	10
20 per cent and higher	3	4	2
Total number of countries	**52**	**52**	**52**

Source: International Monetary Fund, 2006.

IV. External balances also driven by developments in the resource sector

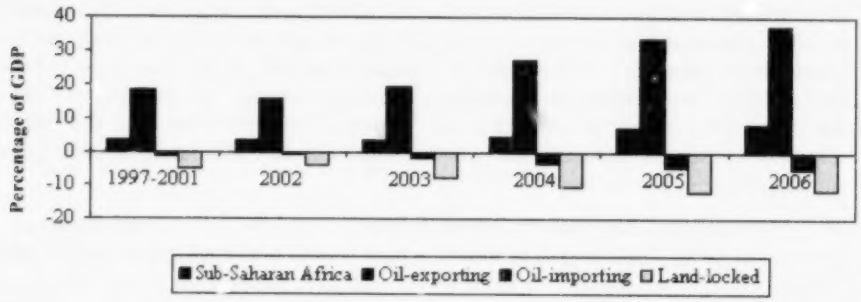
A. Developments in the balance of payments

22. For the third consecutive year, Africa achieved a positive and increasing current account surplus (from 2.3 per cent of GDP in 2005 to 3.6 per cent in 2006, i.e. from US$ 18.4 billion to US$ 33.1 billion), thanks to higher commodity export revenue, especially from oil. Africa's average balance of payments position largely reflects developments in resource-rich countries. With the exception of the Sudan, all oil-exporting countries had current account surpluses, while only two non-oil economies (Morocco and Namibia) had current account surpluses. Namibia is a mineral-rich country and Morocco has a diversified export sector and significant mineral wealth. Additionally, workers' remittances and tourism receipts are important in explaining current account surpluses in Morocco in recent years (Bank

Al-Maghrib, 2005). Eighteen of the 39 non-oil economies with adequate data experienced deterioration in the current account position in 2006, up from 11 economies in 2005.

23. Oil-exporting countries have recorded increasing trade surpluses, while their oil-importing counterparts experienced deepening trade deficits (figure 6). The trade surplus for oil exporters as a group more than doubled from 2002 to 2006 (from 16 per cent of GDP to 37 per cent) while oil importers as a group saw their trade deficit deteriorate from –4 per cent of GDP to –11 per cent of GDP over the same period. Deterioration of the trade deficit was even more pronounced for landlocked countries. The continuing rise in oil prices raises serious concerns about the sustainability of the current account among oil importers and the associated effects on overall economic performance and macroeconomic stability.

Figure 6
Trade balance in Africa by category (percentage of GDP), 1997-2006



Source: International Monetary Fund, 2006.

B. Exchange rates and the impact of commodity booms

24. In 2006, 35 African currencies appreciated against the United States dollar, although the rates of appreciation remained moderate (less than 5 per cent). The Zambian kwacha continued to record the highest rate of appreciation (23 per cent) for the second year in a row because of the high copper price and growing investor confidence, especially after the country's qualification for debt relief (ECA, 2006b). Large volumes of speculative capital inflows, targeting government securities, have also played a significant role in the appreciation of the Zambian kwacha.

25. Exchange rate appreciation was also notable for the Sudanese dinar (12.5 per cent) and the Angolan kwanza (8.5 per cent) owing to higher oil revenues and FDI flows. Conversely, the Zimbabwean dollar had the largest depreciation (87 per cent), followed by the Malawian kwacha (13 per cent). Zimbabwe and Malawi experienced a decline in exports and increased food imports because of slow recovery from the drought of 2005, while Guinea faced a near-depletion of foreign reserves.

26. Many African countries have accumulated substantial foreign currency reserves in recent years with the desire to hedge against external shocks. However,

excessive foreign exchange reserves hoarding takes away resources that would otherwise be used to boost domestic economic activity. A better approach is to adopt a comprehensive strategy for prudential regulation and capital controls that can minimize exchange risks while allowing the country to benefit from increased export revenue and FDI inflows. The types of controls to implement should be country-specific (Pollin and others, 2006). Interventions will have to rely on a set of indicators for early-warning systems that monitor movements in foreign exchange, the exchange rate, the structure of external debt and other financial risk indicators. The ultimate goal is to allow African countries to utilize these resources to increase private and public investment so as to accelerate growth.

C. External debt remains high and private capital flows insufficient

27. The hope that Africa's external debt will be significantly reduced under the Heavily Indebted Poor Countries (HIPC) Initiative and that economic reforms will stimulate private capital inflows has been very slow to materialize. Africa's total external debt stock stood at US$ 244 billion in 2006 compared with US$ 289 billion in 2005 (International Monetary Fund, 2006). Although the debt stock declined considerably relative to GDP (from 35.9 per cent in 2005 to 26.2 per cent in 2006), total debt service obligations remained almost unchanged (4.2 per cent of GDP in 2005 and 4.1 per cent in 2006) because of higher interest rates. The debt burden seriously constrains spending on public investment and ultimately retards growth and employment generation.

28. The continent has benefited from substantial inflows of external financing in the form of ODA (including debt relief), which should boost economic growth in the coming years. The Multilateral Debt Relief Initiative announced at the G-8 summit in Gleneagles, Scotland in 2005 provided much needed relief for 13 sub-Saharan African countries. However, it is clear that this debt relief package is not enough and that more external funding will be needed, especially in view of the fact that Africa's gross domestic savings rate (19.7 per cent of GDP) in 1998-2006 is far lower than that during the pre-reform era, 1974-1985 (24.5 per cent) (table 3). Moreover, Africa's gross domestic investment rate (25.4 per cent) in 1998-2006 remains lower than the level (34.2 per cent) considered necessary for halving poverty by 2015 (ECA, 1999). The low level and poor quality of investment contribute to the inability of most African countries to achieve and sustain high growth rates over the medium-term (Berthelemy and Soderling, 2001).

Table 3
External flows, domestic savings and investment during 1998-2006

Indicator	*Oil economies*	*Non-oil economies*	*Africa*	*Source*
ODA (Billions of US dollars, average annual)	4.5	14.4	18.9	World Development Indicators (WDI) 2006
FDI (Billions of US dollars)	7.3	5.9	14.0	UNCTAD, *World Investment Report 2006*
Remittances (US$ billion)	7.6	5.2	12.8	WDI 2006
Other private flows			-6.1	IMF World Economic Outlook Database
Gross domestic investment (% of GDP)	22.1[a]	18.4[b]	20.2[c]	WDI 2006
Gross domestic savings (% of GDP)	24.2[d]	15.1[e]	19.7[f]	WDI 2006

Notes: FDI is for 1998-2005; other private flows are for 1998-2006; for the remaining indicators the data are for 1998-2004. Owing to data unavailability, the following countries have been excluded: (a) Equatorial Guinea and the Libyan Arab Jamahiriya; (b) Djibouti, Lesotho, Liberia and Somalia; (c) Equatorial Guinea and the Libyan Arab Jamahiriya, Djibouti, Liberia, Lesotho, and Somalia; (d) Equatorial Guinea, and the Libyan Arab Jamahiriya; (e) Djibouti, Liberia, and Somalia; (f) Equatorial Guinea, Djibouti, Liberia, the Libyan Arab Jamahiriya and Somalia.

V. Social development

29. The present section of the overview assesses recent progress on social development in Africa against the backdrop of recent sustained improvements in economic performance across a large swathe of countries in the region. It focuses on non-Millennium Development Goals social development indicators, since the Millennium Development Goals are covered in another document. The key message of the present report is that improvements in social development lag significantly behind improvements in economic performance. Thus far, economic growth has not translated into improvements in social development. One reason for this is the fact that social indicators change rather slowly. Another reason could be the dearth of data on human development indicators across the region.

30. Furthermore, African countries are making progress in reducing or slowing the spread of HIV/AIDS, and access to treatment for people living with HIV/AIDS is improving. However, the prevalence rate remains high relative to other regions of the world. It is also apparent that social exclusion is rising in Africa and that the rising crime rate, especially in some of Africa's leading economies (Kenya and South Africa), is a direct consequence of this factor. Overall, countries are intensifying their interventions to improve social development indicators across the continent. A number have demonstrated their commitment in this direction by creating special dedicated ministries of social development.

A. Social exclusion

31. Recent economic growth in Africa has not been broad-based. A significant proportion of the population of African countries has not benefited from higher growth rates, which has resulted in alienation and exclusion. Although we do not have data on the extent of exclusion in Africa, we can use the unemployed as a significant group.

32. Exclusion has three principal dimensions: economic, social, and political. The economic dimension is a direct product of poverty and the excluded find themselves entirely eliminated from the labour market and thus deprived of a regular income. In addition, their access to assets such as land and credit is limited. The social dimension of exclusion further restricts access to infrastructure, services such as education and health, and social security, as well as community and family support. Political exclusion implies that certain categories of the population, such as women, ethnic and religious minorities, or migrants, have no voice and therefore do not participate in the decision-making process, leaving the poor with no opportunity to change the course of events.

33. Poverty is one of the factors contributing to exclusion but does not necessarily bring it about. Several factors, including the HIV/AIDS pandemic, globalization, drought and conflicts in a number of African countries, also contribute to the phenomenon of exclusion.

B. Progress on gender remains slow

34. The Beijing Platform for Action drew international attention on the feminization of poverty and stressed that the eradication of poverty could not be accomplished without democratic participation and changes in economic structures in order to ensure access for all women to resources, opportunities and public services. The Platform for Action advocated for the adoption of macroeconomic policies and development strategies that addressed the needs and efforts of women, and the revision of laws and practices to ensure women's equal rights and access to economic resources. However, 12 years on, poverty still disproportionately affects women in the majority of African countries.

35. According to the ECA African Gender and Development Index (AGDI), there are significant income differentials and disparities in terms of access to and control over productive assets, such as land and credit.[4] The average gender parity index for the three indicators used to assess inequalities in access to resources (ownership of rural/urban plots/houses or land, access to credit and freedom to dispose of own income) shows that women's access to resources is only half that of men. The index further highlights the fact that women continue to face a higher work burden in the household and care economy, limiting further their ability to fully participate in and benefit from development processes.

36. In addition to the Beijing Platform for Action, African countries have strengthened their commitment to the Convention on the Elimination of All Forms of Discrimination Against Women. So far, 51 out of 53 countries have ratified the

[4] The AGDI is a composite index developed by ECA to measure gender inequality in the social, economic and political spheres.

Convention. However, by June 2006, only 12 African countries had ratified the Optional Protocol to the Convention, which provides a mechanism for reporting State violations. Furthermore, measures taken by the Convention Committee to address the concerns raised are not binding.

37. Within the framework of AGDI field studies in 12 countries, the ratification and effective implementation of the Convention by member States were scored across a range of qualitative indicators including but not limited to ratification, policy commitment, targets, budget and human resources. The studies revealed that all 12 AGDI-surveyed countries have put in place policy initiatives to mainstream gender into all sectors of development. Two countries have even gone further to set quantifiable targets to assess progress made. This portrays an encouraging picture, indicating that Africa is striving towards gender equality. However, real implementation of women's human rights provisions requires adequate resources. National resource allocations to address the Convention remain nevertheless too low.

38. Women's access to land remains poor. With about 70 per cent of all Africans earning their livelihood from agriculture, falling agricultural productivity means the exacerbation of poverty levels and food insecurity. One of the serious constraints to increased productivity is the land tenure system and exclusion of certain groups and categories from access to land. As access in most of rural Africa continues to be determined by indigenous/communal systems of land tenure, women's equal rights to land are too often neglected.

C. Migration and development

39. Migration has been an issue of serious debate in the international sphere in recent times. In 2006, the United Nations held the High-level Dialogue on Migration and Development to discuss the challenges and opportunities of international migration.

40. In Africa, migration flows display a wide range of patterns, modulated by strategies to cope with factors such as economic and ecological problems, intraregional disparities in economic well-being, political instability and restrictive migration policies. African international migration involves a wide range of voluntary and forced cross-border movements within the continent, as well as regular and irregular migration to destinations outside the continent. Migration streams within Africa are much larger than those out of Africa, and forced migration plays a significant part. African nations, already struggling to provide for their own populations, were harbouring about one third (three million) of the world's refugees at the end of 2005.

41. Conflicts have effectively resulted in increased numbers of internally displaced people and refugees in Africa (table 4). Internally displaced people and refugees experience many forms of social exclusion, particularly women and children. This social group also faces a higher rate of exclusion from education and health services, which is further exacerbated by their unclear legal status.

Table 4
Internally displaced people and refugees in selected African countries, 2005

Country	*Internally displaced people (thousands)*	*Refugees by country of origin (thousands)*
Sudan	5 355	693
Uganda	1 740	38
Zimbabwe	570	11
Kenya	382	5
Eritrea	64	144
Côte d'Ivoire	800	18
Democratic Republic of the Congo	1 664	431
Burundi	117	439
Angola	82	216

Source: United Nations, A/60/871.

42. International migration impinges on development in Africa in a wide range of ways. A key challenge for African countries with serious human resource shortages is skills migration or "brain drain". Particularly difficult is migration in the case of the health sector. As Africa is facing increasing demand as a result of HIV/AIDS and other diseases, several countries also experience a net depletion of their health workforce. For example, 926 Ghanaian doctors practise in the Organization for Economic Cooperation and Development (OECD) countries alone, representing 29 per cent of the doctors still practising in Ghana (A/60/871).

43. There are, however, also benefits from migration. Africans in the diaspora transfer resources across time and space that are then used to reduce poverty and enhance economic development. In 2004, remittances to Africa amounted to US$ 14 billion, with Egypt, Morocco and Nigeria being the largest recipients. Migrants are also transferring investment and venture capital, skills and new technologies to their countries of origin. Much of the remittances are used for consumption, health care and schooling, but a substantial proportion is used for housing and investment. The challenge in this regard is for countries to design policies that help reduce the transaction costs of remittances.

D. Ageing population

44. Although only 5.2 per cent of the total population is aged 60 or over, ageing is becoming a growing challenge for the region (United Nations, E/CN.5/2007/7). This means that the coming decades will see a rapidly increasing percentage of the population over the age of 60. In 2000, 4.6 per cent of the total population were aged 60 years or over. In 2050, the United Nations predicts that this figure will increase to about 8.1 per cent of the total population. This trend will have major impacts on the economic and social well-being of the elderly in Africa.

45. Even if it is expected that Africa's elderly population will be better educated compared to previous generations, there is no guarantee that this older generation will experience more prosperous and healthier lives in old age. They will be

threatened by poverty because of the lack of old-age pension schemes in many countries, as well as by the HIV/AIDS epidemic which has turned many of them into parents again. Poverty is also going to be a major threat among older women, especially those living alone in both rural and urban areas. Finally, the effects of ageing on health-care costs are likely to be considerable given that elderly people, in general, consume more health care.

E. Employment and youth

46. Africa's official unemployment rate persists at 10 per cent. However, when comparisons are made on a subregional basis, Southern Africa had the highest unemployment rate, 31.6 per cent, while East Africa had 11 per cent, Central Africa had 9.4 per cent, North Africa had 10.4 per cent and West Africa had the lowest rate, 6.7 per cent (ECA, 2005). Unemployment has been found to be high among some disadvantaged groups, including women, the youth, people with disabilities, people living with HIV/AIDS, cross-border migrants and the elderly (ECA, 2006b). For example, the national unemployment rate for South Africa was 26.7 per cent in 2005, while the unemployment rate among black Africans was the highest, at 31.5 per cent, compared to 22.4 per cent among coloured people, 15.8 per cent among Indians/Asians and 5.1 per cent among white people. Furthermore, across much of Africa, finding productive and decent work is a major challenge for Africa's youth. In fact, the ratio of youth to adult unemployment was 3.6 in 1993 and remained virtually unchanged at 3.5 in 2003 (International Labour Office, 2004). Youth find themselves at the end of the job queue for the formal labour market because they do not have any work experience, and they often do not possess efficient social networks. This means they will be virtually excluded from reasonably paying formal employment, forced either into atypical or vulnerable forms of formal employment with low pay or the informal sector with limited legal protection. The situation is much worse among young women, who continue to face numerous barriers in the labour market.

F. Orphans and vulnerable children

47. Orphans and vulnerable children constitute one of the groups most vulnerable to social exclusion in Africa today. This group is largely a result of the AIDS pandemic, as well as displacement caused by civil conflict, wars, drought and floods. The total number of orphans due to AIDS reported in Africa at the end of 2005 was about 12 million, representing a very large proportion of the 0-17 year age group (Joint United Nations Programme on HIV/AIDS, 2006). One of the main consequences of orphanhood is limited access to education. Traditionally, in Africa the extended family and the community at large were responsible for assisting orphans socially, economically, psychologically and emotionally. However, extended family systems are now under stress due to mounting needs as a result of high mortality among adults of reproductive age and deepening poverty, and are thus failing to secure education for all orphans in need. Furthermore, although conventions on the rights of the child have been ratified by a large proportion of African States, their conversion into policies lags behind, with child labour and prostitution still observable in many parts of the continent. In addition, child labour is a major problem in Africa, particularly in the agricultural and informal service

sectors. It is estimated that 49.3 million children in sub-Saharan Africa are involved in the labour force (International Labour Office, 2006). Children are forced into the labour force or indentureship by their families in order to help alleviate the immediate impact of extreme poverty and hunger.

48. The social consequences of orphaned and vulnerable children are great. By not receiving an education today, orphans risk exclusion in the future. Children orphaned or made vulnerable by HIV/AIDS not only are at greater risk of missing out on an education, but they may also face stigmatization and neglect in their communities. Trafficking and commercial sexual exploitation are yet another consequence of the lack of protection facing these children. The magnitude of both child trafficking and commercial sexual exploitation in Africa cannot be accurately quantified because of lack of data, but it has been estimated that 50,000 children are in prostitution and pornography (ILO, 2006). Children involved in commercial sex activities are often subjected to rape, physical and psychological abuse and starvation. Incidences of unwanted pregnancies and sexually transmitted infections, including HIV/AIDS, are also high among these children.

G. Crime

49. Crime has become a serious social and economic problem in many African countries. A consequence of unemployment and urbanization, it is now a major cause of death in the region. The death rate attributable to violence in Africa is estimated at 60.9 per 100,000 population. This is over twice the global rate and substantially higher than for other regions (World Health Organization Regional Office for Africa, 2004). In addition, the more vulnerable groups account for a disproportionate part in the official statistics. Indeed, Gun Free South Africa, an advocacy group, has stated that 12 per cent of gun death victims in 1998 were young women, and about 7 per cent of the victims were under the age of 17 (Fleshman, 2001). According to the Nairobi Youth and Crime Survey, young offenders and ex-offenders interviewed said that the major offences they had been arrested for were theft, followed by assault and drug possession (United Nations Human Settlements Programme, 2002). In addition, political instability and conflict are often the outcome of social exclusion, and the more vulnerable suffer the brunt of this phenomenon, which is underpinned by the 100 million illicit small arms in Africa. For example, children recruited as soldiers are denied education and protection and are often unable to access essential health-care services, while those who are displaced, refugees or separated from their families face similar deprivations. Conflict heightens the risk of children being exposed to abuse, violence and exploitation, with sexual violence often employed as a weapon of war.

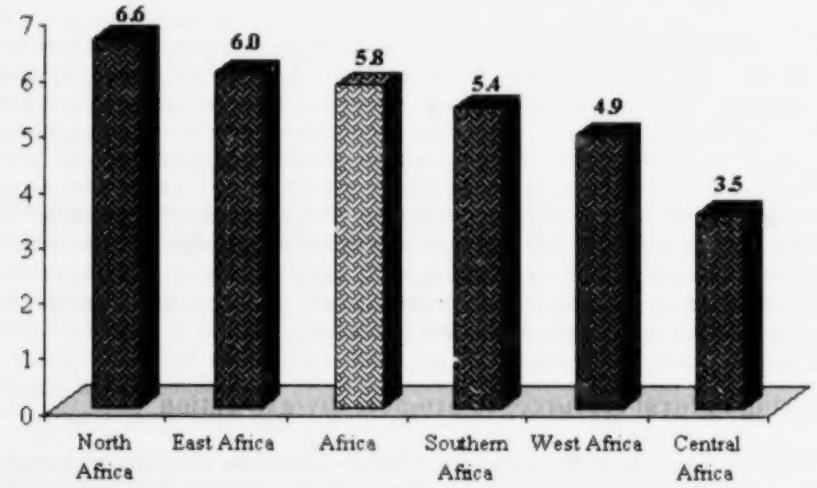
VI. Growth prospects for 2007 and medium-term outlook

50. Africa is expected to grow at a rate of 5.8 per cent in 2007, slightly higher than the rate of 5.7 per cent recorded in 2006 (figure 7). Positive growth rates are projected for all subregions: North Africa (6.6 per cent), East Africa (6.0 per cent), Southern Africa (5.4 per cent), West Africa (4.9 per cent) and Central Africa (3.5 per cent). Despite deceleration of growth in major industrial economies, global demand for African products, especially oil, minerals and agricultural commodities, is

expected to remain steady owing to strong growth in emerging Asian economies, especially China. Moreover, delivery of the promised aid and debt relief will allow African countries to boost expenditure in key sectors, including infrastructure and social services. Consolidation of macroeconomic management will not only reduce inflation in the short run, but also contain long-term inflation expectations, which will encourage private investment.

51. A number of factors are likely to hinder growth in 2007 and subsequent years. Economic growth in many countries will be compromised by the increasing spread of the HIV/AIDS pandemic, which undermines labour supply and labour productivity. Lack of diversification of production and exports constitutes an important source of potential instability and vulnerability to shocks emanating from changes in commodity demand and prices, as well as unpredictable weather changes. Inefficient public infrastructure and unreliable energy supply at the national level, as well as poor integration of transportation and energy networks at the regional level, will continue to undermine productivity and international competitiveness, ultimately slowing economic growth (ECA, 2006c).

Figure 7
Projected real GDP growth by region for 2007 (percentage)



Source: Economist Intelligence Unit, 2007.

VII. Conclusion and policy recommendations

52. Despite notable economic recovery in Africa since the turn of the twenty-first century, the continent still faces important challenges in attaining its development goals. Being highly commodity-dependent, growth remains volatile and too low for achieving the Millennium Development Goals while pressure from oil prices threatens price stability in oil-importing countries. Macroeconomic balances are driven by developments in the resource sector and may worsen for oil-importing African countries if high oil prices persist in the medium term. Moreover, external

debt remains high and private capital flows insufficient to bridge the gap between domestic savings and the necessary investment for Africa to meet the Millennium Development Goals. Furthermore, the continent needs to design and implement integrated policy measures in order to address key challenges in the domain of social development.

A. Promoting international competitiveness

53. While the medium-term outlook for the world economy remains upbeat and global imbalances have started to stabilize, for African countries there remain some risks arising from competition from Asia and the weakening of housing markets in advanced economies, which could reduce demand and weaken commodity prices. Thus, African countries need to introduce effective measures to promote international competitiveness through increased productivity and diversification of production and exports. At the same time, they need to increase domestic demand and promote regional integration and intra-Africa trade.

B. Policies to improve macroeconomic management and promote high and sustainable growth

54. The majority of African countries have been unable to achieve and sustain the high growth rates necessary for achieving their development goals. Besides sustaining macroeconomic stability, African countries need to tailor their fiscal and monetary policies to promote investment, employment generation and growth. Moreover, it is necessary to adopt innovative growth strategies that can help Governments to identify binding constraints to growth as well as the sources of growth potential at a disaggregated level, and design incentive mechanisms to channel resources to sectors with the highest potential for growth and employment generation. This calls for an innovative diagnostic approach to growth strategies that can effectively address country-specific constraints and identify policy interventions based on country-specific opportunities and objectives.

C. Managing natural resources to promote diversification

55. Economic growth in the majority of African countries is driven by natural resources, namely oil, minerals and agricultural commodities, such as tea, coffee and cocoa. Commodity dependence exposes African economies to shocks emanating from natural factors and fluctuations in demand and commodity prices. To achieve high and sustainable growth, African countries need to use revenues from commodity exports to promote economic diversification.

D. Trade and sectoral policies for diversification

56. In addition to prudential macroeconomic management and the strengthening of institutions, promoting economic diversification requires effective sectoral policies and microeconomic reforms that spur industrialization. This calls for better coordination between sectoral and trade policies with macroeconomic policies. African countries should use trade policies in a strategic way, with a focus on

diversification of products and markets. This will necessitate strategies that are targeted to those sectors that are most closely aligned to the overall industrialization strategy.

E. Investing in energy and public infrastructure

57. Investing in public infrastructure and energy supply is crucial for promoting private investment, accelerating diversification and increasing access to social services for the majority of the population. Oil-importing African countries in particular need to reduce their dependence on oil by making use of alternative sources of energy, especially hydropower, and by utilizing cost-effective technologies.

F. Designing pro-poor growth policies

58. In addition to developing innovative and employment-generating growth strategies, African countries need to become more innovative in terms of resource mobilization and in the design of pro-poor growth policies in order to tackle the problems of mass unemployment, poverty alleviation and pervasive inequality. Well-targeted social development interventions in the areas of education and health are also critical for promoting shared growth and reducing poverty. These policies should also address youth unemployment by equipping the youth with adequate skills for the labour market and by creating job centres with specific youth programmes.

G. Mainstreaming employment, gender equality and social protection into national development plans and poverty reduction strategies

59. Development planning and poverty reduction strategies are important and widely recognized instruments whereby national policymakers can improve social conditions for their populations. They should, therefore, be used to tackle issues such as high unemployment in African countries, acute gender inequalities and lack of adequate social safety nets.

H. Fighting HIV/AIDS and other pandemics

60. The continent faces the challenge of the expanding HIV/AIDS pandemic. Decreasing costs of treatment and the emergence of simpler treatment regimes provide an opportunity to scale up national HIV/AIDS treatment and care responses besides prevention. This will help to reduce both the direct and indirect costs of HIV/AIDS over the long run. Africa also needs to scale up resources to combat other diseases such as malaria and tuberculosis.

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Summary of the Economic and Social Survey of Asia and the Pacific 2007

Summary

According to the *Economic and Social Survey of Asia and the Pacific 2007*, the Asia-Pacific region grew strongly in 2006, with the developing countries growing at a rate of 7.9 per cent and the developed countries, 2.2 per cent. In keeping with the region's rapid integration with the global economy and the sectors in which it is most internationally competitive, the process of expansion was concentrated in the industrial and services sectors, with agriculture growing at a lesser pace. Economic growth has been broad-based, with all subregions performing robustly. The countries of North and Central Asia, as well as Australia, the Islamic Republic of Iran and a number of other countries, witnessed strong growth in commodity exports, while much of East Asia experienced strong demand for manufactured goods, such as electronics.

For developing economies in the Asia-Pacific region, the economic-growth outlook in 2007 is one of continued dynamism. Economic growth is projected at 7.4 per cent in 2007, somewhat lower than in 2006. The external economic environment is expected to be less favourable, due mainly to the slowing economy of the United States of America. A moderate decline is expected in global electronics demand in 2007 that may affect the Asia-Pacific region's prospects. In the meantime, the easing of commodity prices, including that of oil, will be a mixed blessing for the region.

* E/2007/100.

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The *Survey 2007* assesses the economic and social costs of gender discrimination in the Asia-Pacific region, in particular the economic losses from gender discrimination in relation to low labour-force participation and low level of educational achievement. It also assesses the progress made in gender equality in four areas (economic participation, education, health and empowerment), with a comparative analysis that also highlights best practices. The publication analyses the status of gender inequality and factors leading to current disparities, and proposes policy recommendations to minimize gender discrimination in the region.

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I. Implications of recent economic and social developments

1. The *Economic and Social Survey of Asia and the Pacific 2007* analyses trends in the regional economy against the background of global developments and outlines the main policy issues facing the region. The *Survey* also considers the cost of gender discrimination in Asia and the Pacific and examines the actions that Governments can take to deal with the problem.

2. For the eighth consecutive year, the developing Asia-Pacific economies grew faster than all other regions in the world, with an impressive growth rate of 7.9 per cent in 2006, up from 7.6 per cent in the previous year (see table 1). With Asian and Pacific developing economies accounting for more than one third of global growth in 2006, the region is becoming the locomotive of global growth. In keeping with the region's rapid integration in the global economy and the sectors in which it is most internationally competitive, the process of expansion was concentrated in the industrial and services sectors, with agriculture growing at a lesser pace.

3. The continued buoyancy of external demand remained an important source of growth for many countries in the region, as the much-anticipated slowdown in United States growth failed to materialize in the manner that had been expected in 2006, and the continued revival of the Japanese economy provided an added stimulus. China and India featured as important drivers of external demand in the Economic and Social Commission for Asia and the Pacific (ESCAP) region. China served as an export platform for the region, while its enormous demand for raw materials and fuels continued to keep global oil and commodity prices high, aiding the oil and commodity exporters throughout the region, stretching from the Islamic Republic of Iran to Mongolia to Australia.

4. Economic growth has been broad-based, with all subregions performing robustly. As oil prices soared, so did the gross domestic product (GDP) of the oil- and gas-exporting countries in North and Central Asia, making it one of the world's fastest-growing regions. Heading the pack was the world's fastest-growing country, Azerbaijan, estimated to have grown at a blistering 34.5 per cent in 2006. The other major oil and gas exporters in the subregion also posted rapid expansions: Kazakhstan grew by an estimated 10.5 per cent, the Russian Federation by 6.7 per cent and Turkmenistan by 14 per cent. As the hydrocarbon sector expanded, so did the demand for services and investment. In the Russian Federation, fixed capital expenditure grew by 11.7 per cent in the first nine months of 2006 (year on year). There was also more demand for services. Retail trade grew by 12.7 per cent in the first 10 months of 2006 in Azerbaijan, by 12.5 per cent in the Russian Federation, and by 23.4 per cent during the first half of 2006 in Turkmenistan. Growth was also strong elsewhere in the subregion.

Table 1

Selected economies of the Economic and Social Commission for Asia and the Pacific region: rates of economic growth and inflation, 2004-2007

(Percentage)

	Real GDP				*Inflation*[a]			
	2004	*2005*	*2006*[b]	*2007*[c]	*2004*	*2005*	*2006*[b]	*2007*[c]
Developing economies of the ESCAP region[d]	7.8	7.6	7.9	7.4	4.6	4.3	4.3	3.8
East and North-East Asia	8.4	8.1	8.5	7.8	3.3	2.0	1.6	2.1
China	10.1	10.4	10.7	9.9	3.9	1.8	1.5	2.0
Hong Kong, China	8.6	7.3	6.2	5.7	-0.4	0.9	2.0	2.3
Mongolia	10.6	6.2	7.5	6.0	11.0	9.5	5.1	—
Republic of Korea	4.7	4.0	5.2	4.8	3.6	2.7	2.5	2.5
Taiwan Province of China	6.1	4.0	4.2	4.1	1.6	2.3	0.6	1.7
North and Central Asia	7.5	7.1	7.5	7.1	10.0	11.8	9.4	8.8
Armenia	10.5	13.9	13.4	8.0	6.9	0.6	2.9	3.0
Azerbaijan	10.2	26.4	34.5	30.0	6.7	9.6	8.3	8.0
Georgia	5.9	9.3	7.0	5.0	5.7	8.2	9.2	7.0
Kazakhstan	9.6	9.5	10.5	10.0	6.9	7.6	8.6	7.5
Kyrgyzstan	7.0	-0.6	2.7	6.0	4.1	4.3	5.7	5.4
Russian Federation	7.2	6.4	6.7	6.4	10.9	12.7	9.7	9.0
Tajikistan	10.6	6.7	7.0	7.0	6.8	7.8	11.9	6.5
Turkmenistan	9.0	6.0	14.0	7.0	5.9	10.6	11.0	9.7
Uzbekistan	7.7	7.0	7.3	6.5	1.7	6.9	7.5	8.0
Pacific	3.8	2.7	3.8	3.7	3.4	2.4	2.8	2.7
Cook Islands	4.3	0.1	1.8	3.5	0.9	2.5	3.0	1.5
Fiji	5.3	0.7	3.6	2.0	3.3	2.7	3.5	4.0
Papua New Guinea	2.7	3.3	3.7	4.5	2.1	1.7	1.7	1.5
Samoa	3.7	5.1	3.5	4.7	16.3	1.9	3.2	4.0
Solomon Islands	8.0	5.0	6.2	5.0	6.7	7.2	8.2	8.4
Tonga	1.4	2.3	1.9	0.9	11.0	9.6	7.2	—
Vanuatu	5.5	6.8	7.0	7.0	1.6	0.9	2.3	2.4
South and South-West Asia[e]	7.4	8.0	7.8	7.4	6.3	6.7	7.6	6.2
Bangladesh	6.3	6.0	6.7	6.0	5.8	6.5	7.2	7.0
India	7.5	9.0	9.2	9.0	3.8	4.4	6.0	5.0
Iran (Islamic Republic of)	4.8	5.4	6.1	6.0	15.2	12.1	11.0	9.1
Nepal	3.8	2.7	1.9	4.3	4.0	4.5	8.0	6.0
Pakistan	7.5	8.6	6.6	7.0	4.6	9.3	8.0	7.0
Sri Lanka	5.4	6.0	7.0	6.5	7.6	11.6	13.0	7.0
Turkey	8.9	7.4	6.0	5.0	8.6	8.2	9.5	7.1

	Real GDP				Inflation[a]			
	2004	2005	2006[b]	2007[c]	2004	2005	2006[b]	2007[c]
South-East Asia	6.5	5.6	5.9	5.6	4.1	6.0	6.8	4.4
Cambodia	10.0	13.4	8.0	7.0	3.9	5.8	5.0	4.0
Indonesia	5.1	5.6	5.5	6.2	6.1	10.5	13.1	6.8
Lao People's Democratic Republic	6.9	7.2	7.5	7.6	10.5	7.2	7.0	7.0
Malaysia	7.1	5.3	5.6	5.7	1.4	3.0	3.6	3.2
Philippines	6.0	5.0	5.5	5.6	6.0	7.7	6.5	4.5
Singapore	8.7	6.4	7.6	4.7	1.7	0.4	1.0	1.5
Thailand	6.2	4.5	5.0	4.7	2.8	4.5	4.6	3.6
Viet Nam	7.8	8.4	8.2	8.3	7.8	8.3	7.5	6.8
Developed economies of the ESCAP region	2.8	2.0	2.2	2.0	0.2	0.0	0.5	0.9
Australia	3.6	2.7	2.5	3.0	2.3	2.7	3.5	2.5
Japan	2.7	1.9	2.2	1.9	0.0	-0.3	0.2	0.7
New Zealand	4.2	2.1	1.9	1.8	2.3	3.1	3.4	2.0

Sources: ESCAP, based on national sources; International Monetary Fund, *International Financial Statistics (CD-ROM)* (Washington, D.C., IMF, September 2006); Asian Development Bank, *Key Indicators of Developing Asian and Pacific Countries 2006* (Manila, 2006); website of the Interstate Statistical Committee of the Commonwealth of Independent States, http://www.cisstat.com, 26 February 2007; and ESCAP estimates.

[a] Changes in the consumer price index.

[b] Estimate.

[c] Forecast/target.

[d] Based on data for 38 (developing) economies representing more than 95 per cent of the population of the region (including the Central Asian countries); GDP figures at market prices in United States dollars in 2004 (at 2000 prices) have been used as weights to calculate the regional and subregional growth rates. In the case of Pacific island economies for 2006, estimates are based on the figures available.

[e] The estimate and forecasts for countries relate to fiscal years defined as follows: fiscal year 2004/05=2004 for India, the Islamic Republic of Iran and Myanmar; and fiscal year 2003/04=2004 for Bangladesh, Nepal and Pakistan.

5. Growth jumped in East and North-East Asia from 8.1 per cent in 2005 to an estimated 8.5 per cent in 2006. Once again, China's strong expansion dominated the picture, with growth of 10.7 per cent. The services sector is particularly notable for its increase to 10.3 per cent. Services also showed good growth in the Republic of Korea (5 per cent), and Hong Kong, China (6.5 per cent). On the demand side, the share of GDP of China's exports increased to 37 per cent, although export growth decelerated from 28.4 per cent in 2005 to 27.2 per cent in 2006. The share of GDP of gross fixed investment increased from 42.6 per cent to 43.6 per cent. Reorientation of the economy towards consumer demand was yet to be seen, as the share of GDP of private consumption decreased from 38 to 37 per cent.

6. With few exceptions, countries of the Pacific showed positive economic growth in 2006, ranging from slightly less than 2 per cent in Tonga to more than 6 per cent in Vanuatu. Growth was led by the primary sector in Papua New Guinea and the service sector in the smaller countries. Most countries in the subregion maintained trade deficits, as imports, pushed higher by rising oil prices, continued to outpace exports. In many countries, the trade deficit was financed largely by aid and remittances. Increased receipts from tourism and foreign direct investment are

thus essential for them to maintain their balance of payments and foreign-exchange reserves.

7. Strong economic growth continued in South and South-West Asia in 2006. India, the largest economy in the subregion, led the growth momentum by expanding 9.2 per cent. Afghanistan, Bangladesh, Pakistan and Sri Lanka posted growth rates of more than 6.5 per cent, with industry and services the major contributors. Exports increased in all of the countries, but imports grew even faster, due partly to higher oil prices, widening the current-account deficits in Pakistan, Sri Lanka and Turkey. The Islamic Republic of Iran, the only net exporter of oil in the subregion, grew by 6.1 per cent and increased its current-account surplus, the result of higher oil prices.

8. Driven by strong external demand, economic growth in South-East Asia was a robust 5.9 per cent in 2006, up from 5.6 per cent in 2005. As in previous years, strong external demand, especially for electronics (and to a lesser extent, commodities), was the primary source of growth. As a result, the current accounts of the major economies in the subregion are estimated to have remained in surplus, ranging from 25.9 per cent in Singapore to a modest 0.9 per cent in Viet Nam. As in the other subregions, higher oil prices were a source of inflationary pressure. Many countries allowed their exchange rates to appreciate rather than rely solely on interest-rate hikes to cool their economies. Stronger currencies gave monetary authorities an opportunity to end the interest-rate tightening that started in 2004.

9. All three developed countries in the region enjoyed modest growth in 2006. In Australia and New Zealand, capacity constraints tightened, creating inflationary pressure, while Japan was still looking for firm signs that it had graduated from deflation, with limited growth in wages despite signs of labour shortages. Higher labour incomes supported household consumption in Australia and New Zealand, while sluggish labour incomes eroded it in Japan. With the robust economic growth of the past few years, the fiscal positions of Australia and New Zealand remained strong. In Japan, however, the large public debt accumulated during the decade-long recession of the 1990s still haunted the fiscal outlook.

10. Asian currencies performed strongly during 2006, reflecting larger-than-expected current-account surpluses and capital flows, including those for speculative purposes. High interest rates in some countries, investors' appetite for risk, together with excess global liquidity, attracted record levels of portfolio capital to the region. The major currencies appreciated significantly, notwithstanding the sudden portfolio capital outflows in mid-2006 that sent stock markets reeling across the region and currencies depreciating. With regard to widespread fears that currency appreciation was seriously eroding the competitiveness of exporting industries, the movements of real effective exchange rate, the most appropriate measure for gauging competitiveness, show that appreciation was on a lower scale in comparison with nominal appreciation vis-à-vis the United States dollar.

11. Developing countries in the ESCAP region have continued to add to their sizeable foreign-exchange reserves, which reached an unprecedented level of $2.5 trillion at the end of 2006. Six countries and areas — China, the Republic of Korea, India, the Russian Federation, Hong Kong, China and Taiwan Province of China — accounted for over 82 per cent of total reserves. China, which eclipsed Japan to become the world's largest reserves holder, accounted for 40 per cent of the total reserves of the developing countries of the region, or close to $1 trillion.

12. While the huge appetite for reserves in the Asia-Pacific region is partly a reaction to the Asian financial crisis, the large increase in reserves in 2006 points to continuing efforts to put some downward pressure on the region's currencies through official intervention. It is time to seriously consider the benefits and costs of holding excessive amounts of reserves. The prudent level of reserves that would safeguard a country against financial instability needs to be assessed against potential capital losses and quasi-fiscal costs.

13. Current-account balances deteriorated across the region in 2006, due mainly to the rising oil-imports bill though the impact was somewhat cushioned by the appreciation of currencies that made imports cheaper. Strong export performance in many countries offset some of the effects of rising oil prices. The region's exports grew at an impressive 18 per cent, similar to the 2005 rate, while imports growth picked up to 19 per cent from 17 per cent in 2005. As a result, economies in the region recorded larger-than-expected current-account surpluses.

14. The region's exports benefited from healthy global demand, a rebound in the information-technology sector and, for some countries, trade restrictions on China in the apparel sector. Although it showed signs of weakening, robust growth in the United States of America for 2006 has been a key driver of the region's exports. This has been supported by improving demand in Europe and Japan. There was therefore an ideal situation of solid demand from all of the region's major traditional trading partners.

15. The revival of the Doha Development Round should be a priority for the countries of the Asia-Pacific region, which have benefited from freer trade in developing their economies. The failure to revive the Doha Round has been partly responsible for the proliferation of bilateral and regional trading agreements in the Asia-Pacific region. The 62 members and associate members of ESCAP are currently implementing 62 bilateral trade agreements. Another 11 regional trade agreements, with an average number of eight members, are also in effect. Most of these agreements were signed after 2000 and thus represent a new trend for this region. The proliferation of bilateral and regional trade agreements is now a fact of life, and it would be useful for policymakers across the region, particularly in smaller economies, to have a checklist to help minimize costs and maximize benefits to the economy. The checklist should encompass crucial issues at the conceptual, design, negotiation and implementation phases of an agreement (see the *Survey 2007* for more on this issue). Policymakers should aim as a rule of thumb to bring the preferential agreement as close as possible to compliance with World Trade Organization rules.

II. Outlook for 2007

16. For developing Asia-Pacific economies, the economic growth outlook in 2007 is one of continued dynamism. Economic growth is projected at 7.4 per cent for 2007, lower than in 2006. The external economic environment is expected to be less favourable, due mainly to the slowing United States economy. Signs of slowdown in the United States have become clearer since the second half of 2006, as an easing of consumer demand and a cooling housing market are beginning to take their toll on the economy. GDP is expected to grow at 2.2 per cent, notably lower than the 3.2 per cent figure for 2006. In the European Union, a slight slowdown in activity is

expected, with GDP declining from 2.7 per cent in 2006 to 2.4 per cent in 2007. As demand from the United States and the European Union is expected to fall, a moderate decline is expected in global electronics demand in 2007 that may affect the Asia-Pacific region's prospects. In the meantime, the easing of commodity prices, including that of oil, will be a mixed blessing for the ESCAP region.

17. As the international economic environment weakens, growth momentum in the Asia-Pacific region in 2007 is expected to come from strong growth in China and India, and the ongoing recovery of domestic demand in Japan. A rebound in economic growth in South-East Asian economies will add to the growth momentum. Together, these three economies contribute over 60 per cent of the GDP of the Asia-Pacific region and close to 45 per cent of imports, thereby creating considerable opportunities for the region.

18. The inflation in developing Asia-Pacific economies is projected at 3.8 per cent for 2007, down from 2006 levels. Falling oil prices since mid-2006 are expected to lessen inflationary pressures, while tight monetary policies across the region throughout 2006 are expected to reduce inflationary expectations in 2007. The exchange rates are expected to further appreciate in 2007 and this would also help to reduce inflationary pressure in the region. Even though the Governments of some countries, such as India, Indonesia and Malaysia, have eliminated oil subsidies and allowed retail oil prices to reflect international prices, inflationary pressures are expected to be subdued. For some East and North-East Asian economies, such as China and Hong Kong, China and Taiwan Province of China, tightening labour and land markets will bring forth more challenges, although inflationary pressures are expected to be partly offset by tightening monetary policy and exchange-rate appreciation.

19. Managing exchange rates will be the biggest macroeconomic policy challenge in the region in 2007. The nominal exchange rate in almost all countries of the region, especially South-East and East Asian countries, appreciated significantly against the United States dollar in 2006, despite interventions to keep currency values down. The appreciation is expected to continue in 2007, with the United States dollar depreciating further in response to the country's large current-account deficit, and capital continuing to flow into the region because of the favourable economic environment.

20. Following the experience of 2006, it would be increasingly difficult for monetary authorities to pursue an independent monetary policy in response to shocks, while targeting exchange rates in an environment of increasingly open capital accounts. Monetary authorities can choose a combination of any two, but not all three, of the following policy options: monetary autonomy, exchange-rate target, and capital convertibility. Ensuring that exchange rates are more flexible is the only sustainable solution. Greater flexibility should help take away the "one-way bet" that encourages even more capital inflows than would otherwise take place, since markets would quickly realize that the currency could move in either direction. The fear that a flexible exchange-rate regime could become a source of volatility and have significant economic costs may be borne out to a large extent by the fact that, in many countries, foreign-exchange markets are not well equipped to hedge against exchange-rate fluctuations. Small and medium-sized exporters in particular are not able to make use of hedging instruments in managing risks. Attention needs to be

paid to developing such instruments and further strengthening and deepening financial markets.

21. With the expected rebound in domestic demand, particularly for investment in South-East Asian economies and consumption in China, the current-account surplus is expected to decline in Asian economies, though it will remain high. The further appreciation of exchange rates and a reduction in global demand for electronics and information-technology components would also contribute to the decline in the current-account surplus in the region. In particular, a moderate decline in the current-account surplus is expected in China due to policy measures supporting consumption, reduction in oil subsidies, and greater exchange-rate flexibility.

22. For 2007 the economic performance of the Asia-Pacific region is forecast as rather robust, but several downside risks remain. The possibility of a supply-side oil shock and a disorderly adjustment of global imbalances, among others, cannot be ignored. As such, the baseline forecast would be increasingly tilted towards the downside risks. The potential for a supply-side oil shock could provide the impetus for further rises in international oil prices, thereby negatively impacting projected economic growth, inflation and the current account. As spare capacity remains low, even a moderate disruption in production capacity and/or a further escalation of security concerns in the Middle East could raise oil prices above the baseline assumption. The widening of global imbalances is a concern. The current-account deficit in the United States deteriorated by a further $100 billion in 2006. This deficit has been financed by economies registering current-account surpluses. The surplus is, however, increasingly concentrated in a few countries — China, Germany, Japan and oil-exporting economies. A disorderly unwinding of global imbalances would lead to a sharp depreciation of the United States dollar, together with a sudden increase in interest rates. A global recession with severe negative impacts on the Asia-Pacific region would be the result.

23. Within the region, there are some risks emerging from the two largest economies. Sustainable recovery of the Japanese economy depends on the ongoing process of fiscal consolidation to address ballooning domestic debt. Any disruption to fiscal consolidation could negatively affect consumer confidence and spending and, in turn, would threaten the Japanese recovery. As discussed above, the spectacular investment growth in China has raised worries about "overheating". Given the increased importance of intraregional trade and investment linkages, a sharp slowdown in Japan and China could adversely affect other Asian economies.

III. Policy issues and challenges

A. Oil prices

24. High and volatile oil prices were one of the central sources of difficulty in macroeconomic management in the region in 2006. High oil prices have created inflationary pressures, depleted current-account balances and reduced foreign reserves in some countries. The price of oil rose to record levels in 2006, well over $70 per barrel in early August 2006, in response to the geopolitical situation in the Middle East. In real terms, prices surpassed their previous peak, reached during the 1979-1980 oil shock.

25. However, since August 2006, prices have been on a downward trend as a result of decreasing tensions in the Middle East, a hurricane season in the Gulf of Mexico without major disruptions, and a warmer-than-usual winter season in Europe and North America. Nonetheless, further supply disruptions due to political instability in the Middle East and elsewhere cannot be ruled out. Adding to this pressure is the current unusually low level of spare production capacity of major oil producers. Prospects for a continued fall in oil prices to pre-2002 levels, just before the current ascent of oil prices, therefore remain uncertain.

26. Regional growth has so far been resilient to rising oil prices, aided by strong exports, high capital inflows and a benign global economic environment. However, a slowing United States economy and declining global demand for electronics may alter these conditions in 2007. Further hikes in world oil prices would adversely affect regional economic growth, inflation and current-account balances. In oil-dependent Asia-Pacific economies, these impacts are much more pronounced than is the case for industrial countries. ESCAP simulations indicate that emerging Asia's growth would be reduced by 0.16 per cent were there to be a sustained 10 per cent increase in world oil prices. The Philippines, Singapore and Thailand would be the hardest-hit, as they have relatively high oil intensities. While consumer-price inflation would increase for all emerging Asian economies, the effects would mostly be felt in India, Thailand, the Philippines and Malaysia. Current-account balances would deteriorate in all emerging Asian countries, the effects being particularly substantial on Taiwan Province of China, Hong Kong, China and the Republic of Korea. In emerging Asia, current-account balances as a percentage of GDP would deteriorate, on average, by 0.31 per cent.

B. Low level of domestic demand

27. Over the past few years, the relatively low level of domestic demand in East Asian economies has given rise to two types of interrelated concerns. First, the lack of domestic demand is claimed to be one of the key sources of widening global imbalances. Second, declining domestic demand in these economies has meant that they have increased their reliance on exports to drive economic growth. Relying more on exports exposes these countries to the risk of a significant decline in external-demand conditions; however, the risk would be lower for a country relying more on domestic demand, such as India.

28. Investment was the key component that contributed to the declining share of total domestic demand in the crisis-affected East Asian countries, while consumption has remained fairly stable over the period, except in the Republic of Korea. Non-crisis-affected countries, with the exception of China, also saw investment share in GDP decline. Except for Taiwan Province of China, the decline in investment is due to a significant drop in the private-sector investment share in GDP, which has not yet recovered to its pre-crisis level. The share of public investment in GDP in these countries has been relatively constant. Private investment was badly hit in crisis-affected Indonesia, where the share in GDP fell by nearly half, followed by Thailand and Malaysia.

29. Further financial reforms are needed to promote private investment in East Asian economies. Although significant progress has been achieved in strengthening

financial systems in East Asian economies,[1] more can be done, in the wake of the 1997 crisis, to ensure that prudential investors have access to credit. Two sets of critical reforms are needed. First, the implementation of an improved risk-management system should be prioritized so that banks no longer need to be excessively cautious when lending for investment activities. Second, to curb excessive growth of consumer credit, authorities in these countries should adopt prudential minimum payment and income requirements for credit cards. The creation of credit-counselling and debt-management services could help to reallocate the credit more efficiently. Furthermore, capital markets should be further developed as an alternative source of funds for investors. Finally, Governments should take additional measures to create a favourable investment climate for private investment.

C. Economic vulnerability

30. In mid-2006, Asia-Pacific equity markets experienced their greatest drop since 2004. They continued falling throughout May and June, experiencing their greatest monthly decline since September 2002. After a brief respite at the end of June, equity markets were volatile again in July. All countries in the region were affected, suffering record falls for the year. The volatility reversed a sustained period of increases in financial asset values.

31. Markets have been volatile again in recent months, and more turbulence in the coming months cannot be ruled out. Further rises in developed-country interest rates, in particular in the United States, the euro zone and Japan, are possible if inflation shows signs of gaining momentum in these economies. Further oil-price rises could trigger such a response. An abrupt unwinding of global imbalances leading to a strong depreciation of the United States dollar would also trigger significant interest-rate hikes. The result may be a global economic slowdown, with Asian economies contracting due to a drop in demand for their exports. All these factors may reduce the appetite of investors for Asian financial assets. The effects of downside shocks may be amplified by investor overreaction and by contagion from portfolio outflows in other countries.

32. The present uncertainty in financial markets warrants careful monitoring of the economic vulnerability of countries in the region so that any danger signs can be recognized as early as possible. Relying on the economic-growth indicator may be misleading, because robust growth could mask the build-up of vulnerability in the economy and lull policymakers into inaction. Experience from the 1997 East Asian financial crisis shows that, in the lead-up to the crisis, good growth performance across crisis-affected countries concealed the build-up of economic vulnerability. This was in contrast to non-crisis-affected countries, where there was robust economic growth and no significant sign of economic vulnerability.

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[1] After the crisis, weak financial institutions were segregated from strong ones and the latter adopted strict prudential measures in order to raise supervision to international standards. In addition, several measures to assist the recapitalization of banks and financial institutes have been granted. At present, the capital adequacy ratio in these countries is well above 8 per cent, which is the international standard requirement. The ratio of non-performing loans to total commercial bank loans is far lower than it was during the period of the crisis.

33. To assess the overall state of a country's vulnerability to a currency crisis through a sudden reversal of capital flows, ESCAP has developed a composite vulnerability index covering nine emerging countries in the Asia-Pacific region for which data are available. They consist of five East Asian countries affected by the 1997 crisis — Indonesia, Malaysia, the Philippines, the Republic of Korea and Thailand — and four other emerging countries — China, India, Pakistan and the Russian Federation. The composite index combines three aspects of vulnerability to a crisis, as measured in terms of inadequacy of foreign-exchange reserves to short-term debts, excessive expansion in private domestic credit and real exchange-rate appreciation. In the lead-up to the 1997 financial crisis, the index exhibited a persistent downward trend in all of the crisis-affected countries. The trend bottomed out in 1997, when the crisis began and spread. Such a downward trend, by contrast, was not observed in non-crisis-affected countries, such as China, India and Pakistan.

34. With the exception of Malaysia, crisis-affected East Asian countries are displaying renewed vulnerability in 2006. They were less vulnerable to the financial crisis during the period 2000 to 2004 than in the mid-1990s, as shown by an upward trend of the vulnerability composite index. However, the recent reversal of this trend in these countries merits closer examination. Two factors are responsible: the appreciation of their real exchange rates as short-term capital inflows caused appreciation of the nominal exchange rate, and the pass-through of higher oil prices into non-traded goods, adding to inflationary pressures.

D. Structural challenges

35. Continued high rates of growth in the Asia-Pacific region would require not only that sound macroeconomic policies be maintained but also that steps be taken to address structural problems that may hinder sustained growth and development in the future. It may be easier to take serious policy and institutional measures when economic conditions are robust. There are three structural issues of importance in the region.

36. First, the high level of economic activity that has led to high levels of growth has also created a situation in which the region is bearing an increasing share of regional and global environmental production-related burdens. There is evidence that, unless urgent steps are taken to "green" growth, the resulting environmental stresses would constrain the region's growth potential.

37. Second, the rapid decline in fertility and the increase in life expectancy at birth in several countries in South-East Asia and in other developing countries of the region is opening a historic, one-time "demographic window" that provides an opportunity to spur economic growth. The remarkable growth of East Asian countries between the 1960s and the 1990s is partly due to the effective use of this "demographic dividend".

38. Third, there is evidence that urban poverty is much more pervasive in the Asia-Pacific region than is commonly believed and is increasing at a rapid rate. In fact, urban poverty in many countries appears to be as bad as, if not worse than, rural poverty in terms of incidence and depth.

E. Green growth

39. The Asia-Pacific region's contribution to global GDP has been rising steadily over the past decade. As a result of its role as a global production centre, developing countries in the region are shouldering an increasing share of regional and global environment-related burdens. In fact, in more than half of the region's countries, current consumption pressures, as measured by the ecological footprint, exceed the available bioproductive area (productive natural-resource endowment) per capita. The failure of national policy to address these growing environmental pressures will eventually take its toll on economic growth.

40. Conventional environmental-management approaches have focused largely on improving environmental performance by controlling and regulating pollution and effluents from production processes. Environmental regulation remains a necessary part of green growth, particularly with regard to reducing pollution. However, a broader array of policies, economic instruments and management practices are required to make a fundamental change to consumption and production patterns.

41. To enable countries in the region to move towards green growth strategies, there is a need for eco-efficiency indicators that can assess a country's pattern of economic growth, monitor policy outcomes that promote eco-efficiency and allow comparisons of eco-efficiency measures between countries.

F. Reaping the "demographic dividend"

42. During the past half century, Asia has witnessed a considerable decline in total fertility rates: fertility rates have fallen from a high level of 6 children per woman in the period 1950-1955 to 2.4 by 2000-2005. Similarly, there was a remarkable decline in mortality rates in the period preceding the fertility decline, which was, during the initial stages, largely concentrated among younger persons. This particular sequencing of declines in fertility and mortality rates created a bulge in the age distribution, concentrated at the younger ages. Over time, the bulge has moved upward through the age structure to produce a large and rising working-age population with fewer dependent children and older persons to support. The growth in the labour force, along with increasing savings resulting from falling dependency ratios, will provide a tremendous boost to investment and growth in countries of the region. This window of opportunity opens only once in a lifetime and closes within a generation, as the population ages and dependency increases.

G. Urban poverty

43. Over the past three decades, many urban centres in the Asia-Pacific region and their surrounding areas have functioned as engines of economic growth. At the same time, 571 million slum-dwellers in the region — more than half of the world's total — are experiencing the cumulative impact of an oversupply of labour, tenure insecurity, poor infrastructure, pollution and congestion. If this challenge goes unmet, economic growth will be offset by increasingly high costs to keep urban centres functioning, which will place the Millennium Development Goals a little further out of reach in many Asian countries.

44. Slum areas, the physically and institutionally underdeveloped sites where most of the urban poor reside, create multiple challenges for their inhabitants. This finds its expression in the most common definition of slums, namely that they are characterized by one or more shelter deprivation factors: lack of water, lack of sanitation, overcrowding, non-durable housing structures and insecurity of tenure. Jointly with significantly higher costs of living in urban areas, particularly for housing, the psychosocial pressure of the urban cash economy, the vulnerability of the urban poor to natural disasters and interpersonal violence, and significantly higher levels of pollution and related health hazards, slum life thus imposes specific burdens on those who experience it, which calls for specific policies to improve the situation of slum-dwellers.

IV. Gender discrimination

45. Gender inequality, as reflected in the restrictions placed on women's choices, opportunities and participation, is widespread in many parts of the world. It is often pervasive in Asia and the Pacific despite efforts at both the national and global levels to reduce the gender gap. While some aspects of gender discrimination are a by-product of long-standing customs and cultural practices, the lack of a supportive institutional environment, including legal support for ensuring gender equality, can contribute to the perpetuation of discrimination. Gender discrimination is socially structured, and laws, policies and practices have a strong bearing, directly and indirectly, on discrimination against women.

46. Gender discrimination in the Asia-Pacific region is most visible in access to education and health services, economic opportunities and political participation. For example, the extent of gender inequality in certain countries of the region can be so great that female primary school enrolment is as much as 26 per cent lower than that of males. Such disparities are also reflected in access to health services. The female-to-male ratio in the population is dwindling, particularly in North and Central Asia, South Asia and the Pacific island economies, reflecting inadequate access to health services by women. In some countries, one in every 10 infants dies before reaching their first birthday, and one in every 50 mothers dies during pregnancy and child delivery. This is despite the fact that, overall, health services and medical technology have improved over the years even in poorer countries. Meanwhile, violence against women continues, indicating how voiceless women are at both the household level and the national level.

47. Persistent gender discrimination has clear economic and social costs. Deprivation of access to education and health services by women and girls adversely affects labour-force participation and human-capital development, with a negative impact on economic growth and individual welfare. Women's lost opportunities also have an intergenerational impact, as the health, education and well-being of children are adversely affected. Voicelessness and an inability to uphold their rights could deprive women of assets and obstruct economic and social participation. Violence against and abuse of women could have lifelong psychological costs that could negatively impact women's self-esteem and capabilities, all having direct and indirect economic and social costs. ESCAP estimates show that the region is losing $42-47 billion annually due to restrictions on women's access to employment alone. Similarly, gender inequality in education costs the region about $16-30 billion per year.

48. The elimination of gender imbalances would inevitably bring tangible benefits not only to the individual but also to society at large. Eliminating gender discrimination and achieving gender equality require changes at the household, societal and national levels. In particular, mainstreaming gender concerns in public policies and programmes could make a difference in gender balance. Among the policy options which could help reduce gender discrimination and achieve equality among men and women are: (a) improving the access of women and girls to social resources, such as education and health services; (b) enhancing the economic participation of women; (c) enhancing access to material resources; (d) empowering women; and (e) hearing the voice of women.

49. Lack of access by women and girls to social resources, such as health services and education, is one of the key factors leading to high levels of gender disparity in health and education, particularly in South Asian countries. This is due both to the restrictions imposed on them and to a lack of institutions and resources. Both have to be addressed before gender discrimination can be eliminated.

50. Enhancing the economic participation of women is justified by both economic and social considerations. Direct and indirect restrictions placed upon women by employers, the work environment, public policies, cultural attitudes and the constant struggle to find a balance between work and family life force women to withdraw from the labour force. A change in policies towards the employment of women and in the mindset of individuals is necessary in order to stimulate female labour-force participation.

51. Access to material resources, such as land, houses and credit, is essential not only so that women benefit from the freedom of choice but also so that their voice can be heard. As noted above, both traditions and laws restrict women's ownership of property, including land and houses. Traditional restrictions are influenced by the belief that the holding of assets by women is tantamount to a transfer of ownership and benefits to a third party after marriage. A change in the way that society differentiates between sons and daughters is essential in order to have an impact on gender bias regarding asset ownership.

52. The fact that gender discrimination starts in the family strengthens the case for making the family the centre of the effort to achieve gender balance. That effort could spill over to society at large as gender balance progresses with time. Men can play a significant role in empowering women, making them equal partners and reducing gender discrimination at home, be it related to inheritance of family assets, access to health services and education, food distribution, violence or an equal voice in family decision-making. A change in societal expectations is necessary in order to change men's attitudes towards women and girls, in which civil society should play a lead role.

53. Improving the opportunities for women to make their voice heard is an effective way of reducing the gender imbalance. For this, a change in attitudes is required, and one effective way to accomplish this is through education. Educated fathers, husbands and brothers are more likely than uneducated ones to treat their daughters, wives and sisters equally. An educated woman is also in a better position to have equal representation than an uneducated woman, even at home. Cultural influences could also be addressed in a flexible manner through education. Civil society should take the lead in changing the mindset of men in that regard, while government could provide support for them by eliminating gender-related

restrictions on public- and private-sector employment and nomination for civil-society organizations.

54. Removing gender-based restrictions on women's participation in parliaments, public service, private-sector employment and civil society should be the primary means of increasing women's representation at all levels. Positive gender discrimination, such as reserving a certain percentage of seats for women in local government bodies and national parliaments, may warrant consideration when other policies prove ineffective. However, the objective of giving women the freedom of choice should not be lost by imposing conditions. Women in different societies and cultures may have different aspirations, and that diversity needs to be respected.

55. There is a need to draw the urgent attention of policymakers to gender discrimination because perpetuating it would entail enormous socio-economic costs that the entire citizenry in a country would have to bear. It is the responsibility of all stakeholders, including civil society, the private sector and academia, to place this issue at the centre of the development agenda.

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Latin America and the Caribbean: economic situation and outlook, 2006-2007

Summary

With an economic growth rate in 2006 of 5.6 per cent, the Latin American and Caribbean region marked up its third consecutive year of growth at rates of over 4 per cent. The international environment remained favourable, and the volume of goods and services exports was up by 8.4 per cent for the region as a whole. In addition, higher prices for the region's main export products translated into an improvement in its terms-of-trade equivalent to over 7 per cent. As a result of these gains in earnings, together with increased remittances from abroad, the rise in national income (7.3 per cent) again exceeded gross domestic product (GDP) growth.

These regional averages, however, mask stark differences between countries and subregions. Faster worldwide growth boosted external demand for exporters of natural resources, especially in South America, and for petroleum-exporting countries. Economic expansion is expected to slow slightly in 2007, with the regional GDP growth rate projected at 4.8 per cent. If those projections are borne out, the region's per capita GDP will show an increase of about 15 per cent for 2003-2007, which is equivalent to 3.6 per cent per year.

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I. Introduction

1. The Latin American and Caribbean region posted a gross domestic product (GDP) growth rate of 5.6 per cent in 2006, equal to a 4.1 per cent rise in per capita GDP. Thus, 2006 was the fourth consecutive year of positive growth and the third at over 4 per cent, after the average annual rate of 2.2 per cent recorded from 1980 to 2002. The figure would have been even higher had it not been for sluggish growth in the past few years in the region's two largest economies, Brazil and Mexico, which together represent 60 per cent of the region's GDP. Economic expansion is expected to slow slightly in 2007, with the regional GDP growth rate projected at 4.8 per cent. If the projections are borne out, the region's per capita GDP will show an increase of about 15 per cent for 2003-2007, which is equivalent to 3.6 per cent per year (see table).

Rates of variation in gross domestic product

(Millions of United States dollars at constant 2000 prices)

Country	*2004*	*2005*	*2006*
Argentina	9.0	9.2	8.5
Bolivia	3.9	4.1	4.6
Brazil	5.7	2.9	3.7
Chile	6.0	5.7	4.0
Colombia	4.9	5.2	6.8
Costa Rica	4.1	5.9	7.9
Cuba[a]	4.5	11.8	12.5
Dominican Republic	2.7	9.2	10.7
Ecuador	7.9	4.7	4.1
El Salvador	1.8	2.8	4.2
Guatemala	2.7	3.2	4.6
Haiti	-3.5	1.8	2.3
Honduras	5.0	4.1	5.6
Mexico	4.2	3.0	4.8
Nicaragua	5.1	4.0	3.7
Panama	7.5	6.9	8.1
Paraguay	4.1	2.9	4.0
Peru	5.2	6.4	8.0
Uruguay	11.8	6.6	7.0
Venezuela (Bolivarian Republic of)	17.9	9.3	10.3
Latin America[b]	**6.2**	**4.6**	**5.5**
Caribbean	**3.8**	**4.9**	**7.0**
Latin America and the Caribbean[b]	**6.2**	**4.6**	**5.6**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.

[a] Data supplied by the National Statistical Office of Cuba.

[b] Excluding Cuba.

2. The performance of the economies of Latin America and the Caribbean has not come about in isolation, but is rather part of a picture of widespread growth throughout the world economy. Although the region's growth rates are high from a recent historical standpoint, they fall short of the rates being attained by other parts of the developing world (with the exception of sub-Saharan Africa).

3. It is important to note that, thanks to favourable external conditions and the implementation of macroeconomically sustainable domestic policies, the region's economic growth has been accompanied by a rising current-account surplus and a gradual strengthening of public accounts. Although these developments are reducing the region's vulnerability to external shocks, the situation varies substantially from one country to another, as will be discussed below.

II. Economic policy

4. The countries of the region continued to consolidate their fiscal positions in 2006, as they had been doing over the previous few years. Although much of that growth was due to positive developments in the international economy, fiscal management in a number of countries reflects an interest in pursuing a more solvent macroeconomic policy, as evidenced in the management of budget surpluses and public debt.

Figure I

Latin America and the Caribbean: variations in central Government revenues and spending

(Percentage of GDP)

Source: ECLAC, on the basis of official figures.

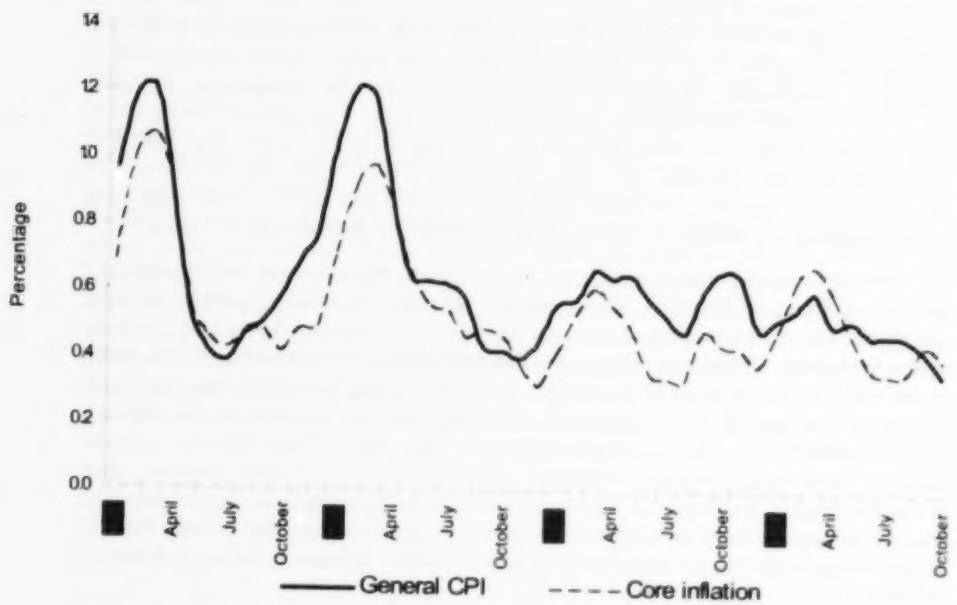
5. At the level of central Governments, the region's fiscal performance yielded a primary surplus of 2.1 per cent of GDP (measured as a simple average) by the close of 2006, as compared with a surplus of 1.4 per cent in 2005, while the overall deficit (including interest on the public debt) narrowed from 1.1 per cent to 0.3 per cent of GDP (see figure I). This increase in fiscal revenue in countries throughout the region, with resources increasing by over 1 per cent of GDP in 2006 for the second year running (which was unprecedented in the period 1990-2004), was mainly driven by higher revenues in some of the countries that specialize in non-renewable commodities.

inflation targeting regime. The second category includes countries that have agreements with the International Monetary Fund (IMF), such as the Dominican Republic and Nicaragua, and others that have no formal understanding with the Fund, such as Argentina and Bolivia. The last group includes Ecuador, El Salvador and Panama, which have no monetary policy as such because their economies are dollarized and their interest rates consequently vary with international rates. In recent years, inflation in the region has, by historical standards, been subdued (see figure III). In 2006, Latin America and the Caribbean posted an inflation rate, in weighted terms, of 4.8 per cent (6.1 per cent in 2005). This indicator has fallen for the fourth consecutive year from the 2002 level of 12.2 per cent.[1] The behaviour of the consumer price index reflected changes in a number of factors. The appreciation of some national currencies in relation to both the United States dollar and the currencies of other trading partners made imported goods cheaper than domestic products (in the case of manufactures) and reduced the impact of higher international commodity prices on domestic prices.

Figure III

Latin America and the Caribbean: monthly variations in the consumer price index and the core inflation index

(Unweighted three-month moving average)



Source: ECLAC, on the basis of official figures.

[1] A major factor in this result was the fall in the inflation rate of Brazil (3.1 per cent compared with 5.7 per cent in 2005). Other countries that succeeded in lowering their inflation rates include Argentina (from 12.3 to 8.8 per cent), Chile (from 3.7 to 2.5 per cent), Costa Rica (from 14.1 to 9.1 per cent), the Dominican Republic (from 7.4 to 5 per cent), Guatemala (from 8.6 to 5.4 per cent), Haiti (from 14.8 to 10.2 per cent), Honduras (from 7.7 to 5.3 per cent) and Panama (from 3.4 to 2.2 per cent).

10. In both 2005 and 2006, as is shown by the reports of the monetary authorities of Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay and Uruguay, higher oil prices in the international market caused prices to rise by more than some central banks had forecast, especially in the region's countries that are net hydrocarbon importers. Given that this rise is the result of a supply factor and may be temporary, before withdrawing monetary stimulus it would be advisable to review economic activity indicators to avert any negative effect on GDP. It should be stressed that the monetary policy of the countries most affected by the oil price rise did not respond to this negative shock.

11. With regard to interbank interest rates, the regional average in December 2006 was 6.5 per cent or, if Brazil is excluded from the sample, 5.9 per cent.[2] This might have been due to a number of factors, especially distortions in financial markets resulting from large reserve requirements, along with the inefficiency of the region's banking sector. Bank lending is more important in Latin America than in economies with deep capital markets. The lending recovery that had begun in 2003 continued in 2006.

III. Domestic performance

12. All the countries posted positive growth rates, in most cases higher than or similar to those of 2005. Chile was the exception, with GDP expansion of 4 per cent over the year (down from 5.7 per cent in 2005). The highest rates were posted in Venezuela (Bolivarian Republic of) (10.3 per cent), the Dominican Republic (10.7 per cent) and Argentina (8.5 per cent). Costa Rica, Panama and Peru grew at rates of about 8 per cent, Uruguay at 7 per cent and Colombia at 6.8 per cent. The lowest figures were for Haiti (2.5 per cent) and Brazil (3.7 per cent). In the rest of the region, GDP growth rates were between 3.5 and 5 per cent.[3] The English- and Dutch-speaking Caribbean countries as a group posted a growth rate of 7 per cent.

13. International economic trends and, in particular, the monetary policy stance of the United States of America, where interest rates rose less than financial markets had forecast at the beginning of the year, together with increased economic activity in the European Union and Japan and the continuing rapid growth of the Asian economies, produced a more favourable situation throughout 2006 than had been forecast at the end of 2005. Thanks to sustained external demand for the region's export commodities, the international prices for them (especially for metals, minerals and hydrocarbons) remained high or even increased further, thus generating higher earnings for the region's countries, especially in South America. The strong expansion of private credit, together with continuing low interest rates in the countries of the region and improved labour-market indicators, boosted domestic demand.

14. In regional terms, in 2006, the volume of goods and services exports expanded (8.4 per cent) at a higher rate than that of GDP, as in 2004 and 2005. Sustained external demand for the countries' export commodities, together with higher levels

[2] The sample includes Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, the Dominican Republic, Ecuador, Honduras, Mexico, Peru, Uruguay and Venezuela (Bolivarian Republic of).

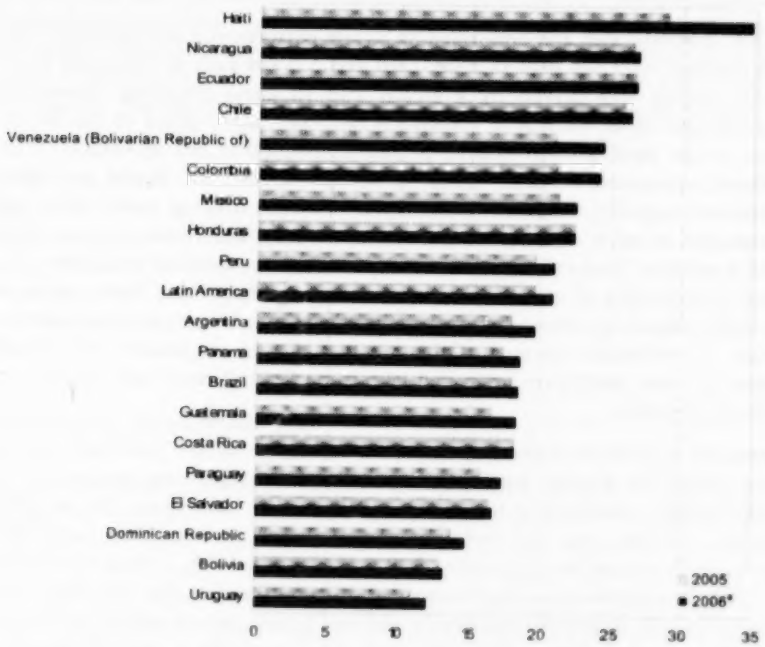
[3] The simple average of GDP growth rates in the Latin American countries was 5.9 per cent and the median was 4.9 per cent (5.1 per cent and 4.7 per cent, respectively, in 2005).

of economic activity and domestic demand for commodities, fuelled intraregional trade in manufactures. The real effective exchange rate has continued to favour exporters in most of the countries, despite the appreciation of some national currencies over the year.

15. In 2006, domestic demand continued its strong performance of 2004 and 2005, posting an increase of 7 per cent (6.2 per cent and 5.5 per cent in 2004 and 2005, respectively), which was driven by a steady rise in gross domestic investment (10.5 per cent) and faster growth in consumption (6 per cent). Some of the factors contributing to the rapid growth in both private consumption and investment were the significant expansion of bank credit to the private sector, thanks to higher domestic-market liquidity, and the maintenance of low lending rates. Although interest rates rose in some countries in 2006, in most they were lower than in 2005, which was a positive factor for both consumption and investment decisions. The appreciation of a number of countries' currencies against the United States dollar in 2005 and 2006 helped to reduce the cost of imported goods, which contributed to the increase in domestic demand. Other factors in the expansion of private consumption (6.3 per cent) were improved labour-market indicators and higher real wages in most countries.

16. Investment growth in 2006 was largely a reflection of the sustained rise in gross fixed capital formation, which has been the fastest-growing component of demand since 2004, expanding at rates of over 10 per cent (see figure IV). In 2006, it was up by 12.2 per cent (13 per cent and 10.7 per cent in 2004 and 2005, respectively), with a cumulative growth of 39.6 per cent in 2004-2006 in relation to values in 2003. The fastest-growing component of gross fixed capital formation was investment in (mostly imported) machinery and equipment, which was up by 14 per cent in 2006, accumulating a 52.8 per cent rise over the period 2004-2006. Investment in construction also continued to expand in 2006, although at more moderate rates of about 9 per cent. Although a part of these increases reflects a return to the investment levels of previous years, the rapid growth seen in 2005 and 2006 was more than enough to exceed previous highs. The volume of goods and services imports grew by 15.1 per cent in 2006, and net exports consequently had an increasingly negative impact on growth for the third consecutive year. The performance of import volumes in 2006 was consistent with the upward trend that this aggregate has shown since 2002.

Figure IV
Latin America: gross fixed capital formation, 2005-2006
(Percentage of GDP, calculated on the basis of constant 2000 United States dollars)



Source: ECLAC, on the basis of official figures.
* Estimates.

17. The positive regional performance of the components of demand was reflected in the expansion of various branches of economic activity. Rapid growth in the construction sector was largely responsible for the rise in gross fixed capital formation in countries such as Argentina, Colombia, the Dominican Republic, Mexico, Panama, Peru, Uruguay and Venezuela (Bolivarian Republic of). In the Caribbean countries, the construction sector also showed a notable increase in activity in 2006 owing to the organization of the Cricket World Cup, which included work on stadium renovation and rebuilding, as well as extension and enhancement of tourist infrastructure. Mining and hydrocarbon production grew more slowly than in 2005, except in Bolivia. Higher domestic demand also boosted industry, partly thanks to higher returns in goods-producing sectors as a result of the devaluations of 2002-2003 in Argentina and Uruguay. The depreciation of the United States dollar in relation to other currencies helped to enhance the competitiveness of manufacturing exports in countries whose currencies are anchored to the dollar (Ecuador, El Salvador and Panama). Growth in the agricultural sector, although positive in all countries except Costa Rica and the Dominican Republic, was less than the increase in overall GDP. The transport sector was boosted by the higher level of domestic activity in the countries, and the buoyant international economy also had a positive impact on tourism-related activities. Increased disposable income in a number of Latin American countries, together with the higher overall level of economic

activity, fuelled an increase in both recreational and business travel. In 2006, the number of tourist arrivals was up by 6.1 per cent in Central America, 7.2 per cent in South America and 3.2 per cent in the Caribbean countries.[4]

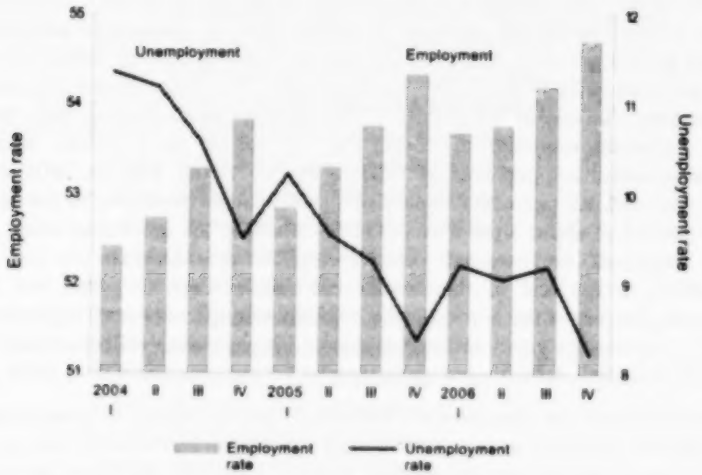
18. One of the characteristics of the current period of economic growth in Latin America is the significant increase in gross national disposable income, which expanded by 7.3 per cent measured in constant 2000 dollars in 2006 (5.9 per cent and 7.1 per cent in 2005 and 2004, respectively).[5] To a large extent, the increase in this aggregate was due to the impact of the trading gains resulting from the terms-of-trade variation recorded in 2006. For the region as a whole, these gains represented about 3.6 per cent of GDP, a higher figure than in 2004 and 2005 (0.4 per cent and 1.7 per cent, respectively). Net factor payments to the rest of the world remained at about 3 per cent of GDP, reflecting the combined effect of lower interest payments on external debt, owing to the decrease in the region's indebtedness to the rest of the world, and the increase in profit and dividend payments to the rest of the world by non-resident enterprises operating in the region. Lastly, the increase in gross national disposable income also reflects rising levels of net current transfers, which were equivalent to 2.2 per cent of GDP in 2006.

19. Together with the considerable increase in gross national disposable income in Latin America, national saving showed significant growth, reaching 23.6 per cent of GDP at current prices, the highest figure since 1990. As has been the case since 2003, in 2006 external saving was increasingly negative, reaching a level equivalent to 1.8 per cent of GDP. Also, as in previous years, in 2006 regional investment was financed entirely from national saving, while the surplus (negative external saving) went to reduce the region's net indebtedness and accumulate reserves and to asset formation abroad by residents. Regional investment as a percentage of GDP stood at 21.7 per cent in 2006; although this is higher than in 2005, it is still below the 1997 value (22.7 per cent), which is the maximum recorded since 1990.

[4] World Tourism Organization, *UNWTO World Tourism Barometer*, vol. 5, No. 1 (January 2007).

[5] The methodology for calculating national disposable income at constant prices developed by ECLAC is described in the *Economic Survey of Latin America and the Caribbean, 2005-2006* (United Nations publication, Sales No. 06.II.G.2).

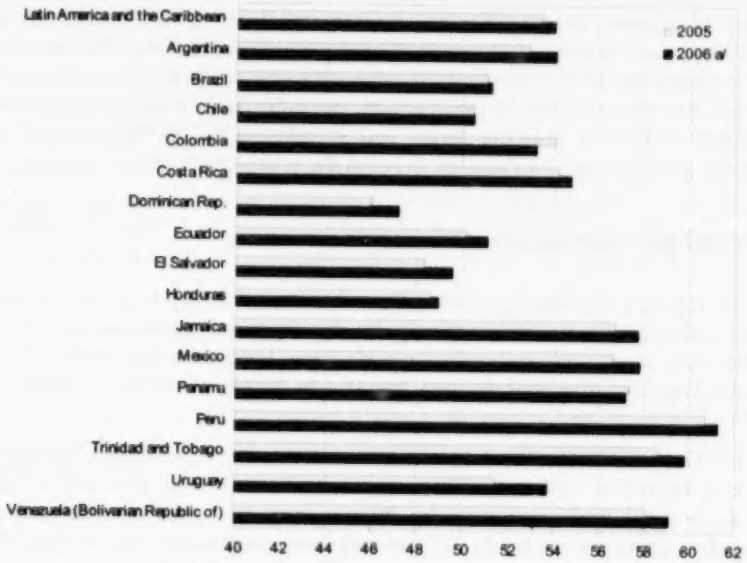
Figure V
Quarterly employment and unemployment rates in nine Latin American countries
(Percentage)



20. The creation of sufficient good-quality jobs remains one of the main concerns in the region. A third consecutive year of relatively strong economic growth improved the main labour-market indicators (see figure V). Boosted by strong labour demand, the employment rate rose again, by half a percentage point, to 54 per cent of the working-age population, the highest rate in 15 years. In contrast with 2005, the labour-force participation rate resumed its long-term upward trend and rose by 0.2 percentage points to 59.3 per cent of the working-age population, thereby making up for the previous fall. Thanks to robust job creation, open unemployment declined for the third year running (by 0.4 percentage points), although by less than the previous year because of the rise in labour-force participation, and the regional unemployment rate stood at 8.7 per cent of the economically active population. In 17 of 19 countries for which data are available, the unemployment rate fell, and in 11 countries there was an improvement of one percentage point or more. Only Brazil saw a rise in unemployment.

21. The employment rate again rose virtually across the region and, of 16 countries, only Colombia and Panama posted decreases in this indicator, in both cases because of a sharp contraction in own-account work (see figure VI). It is noteworthy that a large proportion of recent job creation has been in waged employment. In the relatively high economic growth years of 2004 and 2005, the output elasticity of employment was about 0.55 at the regional level, while waged employment elasticity with respect to output was approximately 0.8. For 2006, similar elasticities are estimated.

Figure VI
Latin America and the Caribbean: employment rates, 2005-2006



Source: ECLAC, on the basis of official figures.
[a] Estimates.

22. The fact that growth in most of the countries was fuelled increasingly by domestic demand, while the external component tended to decline, was reflected in the structure of job creation by branch of economic activity. In practically all the countries for which data are available, employment rates in the construction sector were higher than the equivalent rates for the economy as a whole. Employment in services also expanded rapidly. By contrast, employment in manufacturing increased at below-average rates, in a context of growing international competition. In countries such as the Dominican Republic and El Salvador, jobs were lost owing to a contraction in the maquila textiles sector. Countries with a more diversified maquila industry performed better: in Mexico maquila employment rose by 3.5 per cent and accounted for 1.2 million people, although that was still 7 per cent less than in 2000.

23. Developments in job quality have been a widespread concern. Although there are no comparable indicators for the region's countries in 2006, the scattered information available can be used to draw some conclusions. First, the visible underemployment rate dropped in all the countries for which data are available (Argentina, Colombia, Costa Rica, Ecuador, Honduras, Mexico, Peru and Uruguay), except Brazil and Chile. Second, income indicators suggest that many of the new jobs were low-paying.

24. After a number of years during which economic recovery and rising employment in most countries of the region had no effect on wages, in 2006 formal-sector wages in the region showed the first real increase of over 2 per cent since 1997 (2.6 per cent as a median, 3.3 per cent for the weighted average). Together

with strong job creation, the increase contributed to the upswing in household purchasing power and was one of the main engines of economic growth in 2006.

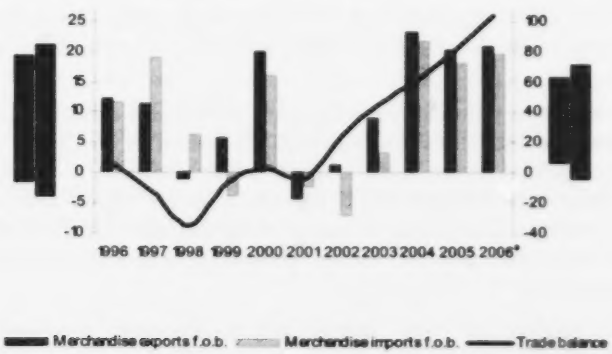
25. To conclude, the analysis of employment quality shows uneven results, while in terms of quantity, job creation has reacted rapidly to economic growth, with a notable increase in formal employment. In many countries, however, the urban formal sector accounts for only a minority of the workforce. Accordingly, even when that sector has posted high rates of job creation, the increase in formal employment has often been limited in absolute terms and in relation to the population's needs. Additional measures are thus needed to boost the creation of productive jobs.

IV. External performance

26. The region's economic growth pattern has been buoyed by a very favourable external environment marked not only by the sustained expansion of the world economy and the growing preponderance of China, India and other Asian economies as the driving force of global demand, but also by highly liquid international capital markets.

27. In 2006, total Latin American merchandise exports plus imports are estimated to have amounted to US$ 1.2 trillion, or the equivalent of 45 per cent of regional GDP, while total trade increased by 20 per cent over the year. In real terms, merchandise exports were up by 7.5 per cent and merchandise imports by 14.8 per cent. For the fifth consecutive year, the region showed a positive trade balance ($103 billion in 2006, or 3.7 per cent of the region's GDP); only seven countries (Argentina, Bolivia, Brazil, Chile, Ecuador, Peru and Venezuela (Bolivarian Republic of)) posted a surplus on their merchandise balance, two fewer than in 2005 (when the list included Colombia and Uruguay) (see figure VII). The countries with the fastest-growing external sales are exporters of extractive industry products, which performed well on international markets, owing to strong increases in the prices of oil, natural gas and copper.

Figure VII
Latin America and the Caribbean: external trade, 1996-2006
(Annual rates of variation for exports and imports; trade balance in billions of dollars)



Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

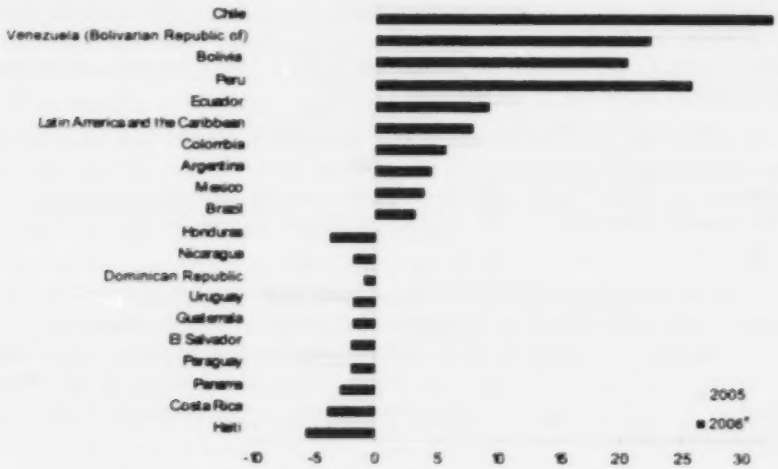
28. A more detailed examination of the exports of South America's two largest economies shows those of Argentina with a 15.1 per cent increase between 2005 and 2006, owing to growth in exports of industrial manufactures (24 per cent) and agricultural manufactures (16.1 per cent). Commodity exports, on the other hand, grew by 10.8 per cent (it will be recalled that soybean prices fell in 2006). Brazil's exports were up 16.2 per cent over the same period, with semi-manufactures climbing by 22.3 per cent and manufactured goods by 14.7 per cent, while exports of commodities expanded by 16 per cent.

29. As in the case of exports, the South American countries saw more dynamic import growth (up 24 per cent in 2006) than the Central American economies (up 14 per cent). In 2006, Latin American imports rose for the fourth consecutive year. For the period 2002-2006, Latin America's import figures showed a 78 per cent increase.

30. Total exports plus imports of services stood at $173 billion, or 6.2 per cent of regional GDP, representing an expansion of close to $17.5 billion over 2005. Services exports are estimated to have increased by 10.4 per cent, while imports grew by 12.1 per cent. The services balance showed a deficit of $21.3 billion (equivalent to 0.8 per cent of GDP), representing a deterioration of $3.3 billion compared with 2005.

31. From 2001 to 2006, Latin America's terms of trade showed a cumulative improvement of 22.1 per cent (see figure VIII). Preliminary figures for 2006 indicate a rise of 7.8 per cent. This amelioration is attributable to a 12.4 per cent increase in the price of exports, while import prices rose by 4.2 per cent. As in 2005, the price increase was concentrated in the petroleum-, mineral- and metal-exporting countries, with Chile, Peru and Venezuela (Bolivarian Republic of) recording the largest terms-of-trade gains, at 33.7, 25.7 and 22.3 per cent, respectively. Meanwhile, net importers of energy products suffered a further downturn, albeit a smaller one than in 2005.

Figure VIII
Latin America and the Caribbean: terms of trade
(Percentage variation, 2005 and 2006)



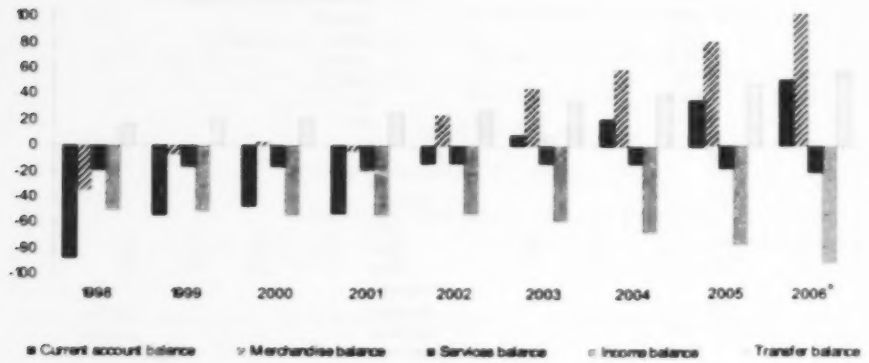
Source: ECLAC, on the basis of official figures.
[a] Preliminary figures.

32. In 2006, Latin America recorded a surplus on its balance-of-payments current account for the fourth consecutive year, an unprecedented achievement for the region. That surplus is estimated at $51 billion or 1.8 per cent of regional GDP, an increase of 43 per cent over 2005 and of 147 per cent with respect to 2004. Seven countries recorded a positive balance on this account: Argentina, Bolivia, Brazil, Chile, Ecuador, Peru and Venezuela (Bolivarian Republic of).

33. In 2006, the merchandise trade balance exceeded the 2005 figure by $22.4 billion, while the current transfers balance was up by $9.4 billion (see figures IX and X). The latter balance reflects an increase in remittances from workers abroad, which have represented significant flows into the region in recent years, the most important beneficiaries being Mexico (which receives more than 40 per cent of incoming transfers), Ecuador and Central America. Such inflows have helped those countries to strengthen their external accounts.

Figure IX
Latin America and the Caribbean: structure of the current account balance, 1998-2006

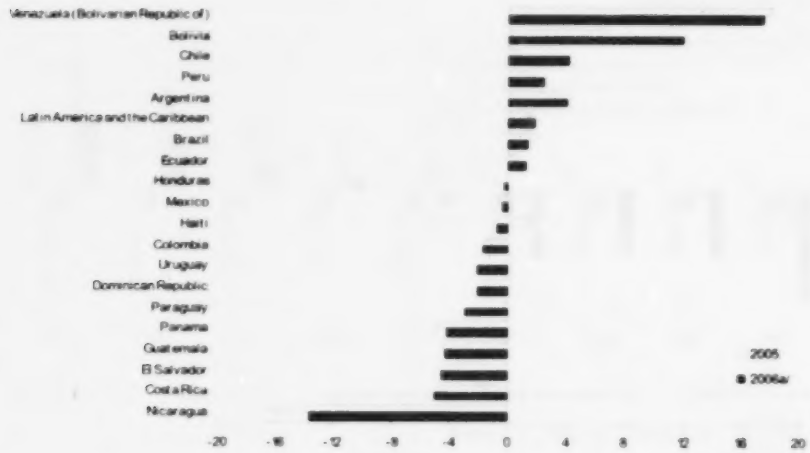
(Billions of United States dollars)



Source: ECLAC, on the basis of official figures.
* Preliminary figures.

34. The services and income balances have both continued to show deficits, which have widened by $3.3 billion and $13 billion, respectively. With respect to the services balance, the non-factor services deficit has widened significantly since 2005, principally as a result of rising maritime freight rates (following the hike in oil prices) and mounting demand for vessels for trade with China. The wider deficit on the income balance is attributable to increased repatriation of profits and dividends. Chile offers an example: in the first half of 2006, outward remittances of profits and interest were 90 per cent higher than in the same period in 2005. Conversely, Argentina improved its interest balance with respect to 2005 thanks to its debt swap operations.

Figure X
Latin America and the Caribbean: current account
(Percentages of GDP in current United States dollars)

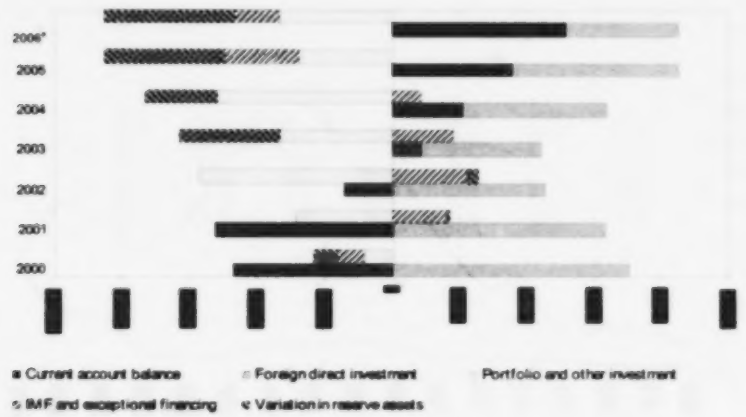


Source: ECLAC, on the basis of official figures.
[a] Preliminary figures

35. In 2006, the capital and financial account[6] of the Latin American and Caribbean region was close to equilibrium, with net flows of financial capital[7] showing a larger negative balance than the previous year, at 1.3 per cent of GDP (see figure XI). Net foreign direct investment (FDI) was lower than in 2005, representing 1.2 per cent of GDP. Financial capital flows reflected bond issuance, debt restructuring and external asset formation by the public sector, as well as private-sector financing and investment strategies. Despite rising interest rates in the United States in the first half of the year, international market liquidity continued to drive the positive take-up of financial securities issued by the countries of the region in international markets. Foreign investors in Latin American and Caribbean markets, on the other hand, benefited from the deeper development and increased openness of domestic markets, the prevalence of high real interest rates (in Brazil, for instance) and the nominal appreciation of local currencies.

[6] Including errors and omissions.
[7] Financial capital flows are defined as the capital and financial balances (including errors and omissions) minus the net flow of foreign direct investment.

Figure XI
Latin America and the Caribbean: breakdown of basic balance, 2000-2006

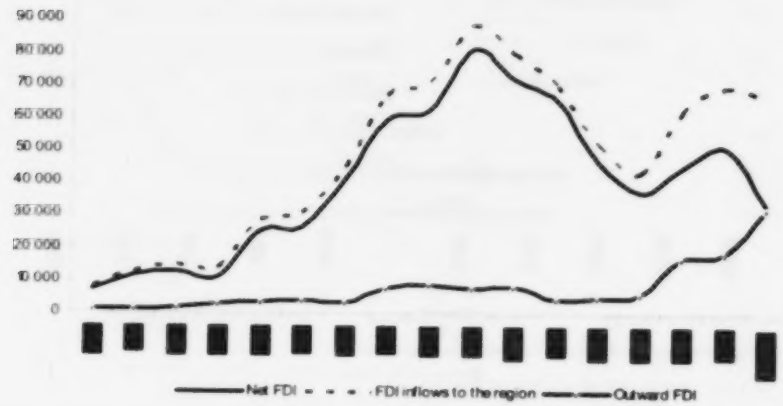


Source: ECLAC, on the basis of official figures.
Note: Negative variation indicates an increase in reserve assets.
[a] Estimates.

36. Outward direct investment on the part of the region's countries has increased significantly over the past two years (see figure XII). In 2006, the strong upswing in outward direct investment on the part of the region's countries, largely attributable to the acquisition by a Brazilian firm of a Canadian metals company, combined with a slight drop in FDI received,[8] resulted in a fall in net FDI (from 2.1 per cent of GDP in 2005 to 1.1 per cent in 2006).

[8] FDI inflows reflected several sales of assets by foreign companies to national companies and the appreciation of the exchange rate.

Figure XII
Latin America and the Caribbean: foreign direct investment
(Millions of United States dollars)

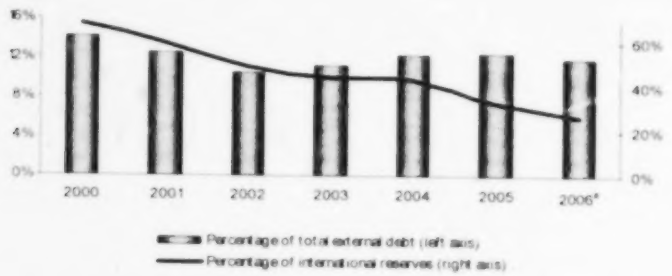


Source: ECLAC, on the basis of official figures.
[a] Estimates.

37. As a consequence of capital movements throughout the year, the balance on the regional capital and financial account was close to equilibrium. This, combined with the current-account surplus, once again generated a large build-up of reserves in most of the region's countries (estimated at 1.4 per cent of GDP). The external debt outcome resulted from debt-restructuring operations (redeeming more expensive bonds with shorter maturities and swapping external debt securities for local currency-denominated bonds), but also from debt-relief measures and early payments to international bodies. The Multilateral Debt Relief Initiative was approved by IMF in January 2006 and by the World Bank in March, and has benefited Bolivia, Guyana, Honduras and Nicaragua. In November, the Inter-American Development Bank (IADB), the region's largest multilateral creditor, announced the creation of a debt-forgiveness framework for those same countries and Haiti, which was approved in March 2007.[9] Argentina and Brazil settled all their debts with IMF in 2005,[10] and, in 2006, Uruguay followed suit and paid off its entire debt to the Fund (some $2.4 billion) ahead of time. Uruguay also undertook early payments of its debt to the World Bank and IADB ($420 million), while Mexico paid off $9 billion to the same institutions. Brazil settled its debt with the Paris Club ($2.6 billion) in the form of several payments made during the first half of the year.

[9] Haiti reached the decision point under the Heavily Indebted Poor Countries (HIPC) Initiative in November, which qualified it for debt relief under that scheme.
[10] Argentina's payment was made effective in January 2006.

Figure XIII
Latin America and the Caribbean: short-term external debt
(Percentage)



Source: ECLAC, on the basis of official figures and information from the World Bank.
* Estimates.

38. As a result of these developments, the level of external debt fell again, to 24 per cent of GDP in 2006. In addition to reducing the amount of external debt, the countries of the region have made efforts to change their debt structures by diversifying the currencies of denomination (often by swapping external for domestic debt), increasing the proportion of fixed-rate debt and cutting short-term external debt (see figure XIII). With respect to this last point, in 2006, public sector debt accounted for a small portion in most of the countries, which means that most of the total is short-term private external debt. This strategy has helped to reduce the region's external vulnerability.

V. Current situation and outlook for 2007

39. International conditions should remain positive for the region in 2007, although less so than in 2006, as global growth is forecast to slow. The expansion that began four years ago is expected to continue in 2007, although at a somewhat slower rate than in 2006. Regional economic activity is expected to expand by about 4.8 per cent, which will translate into an increase of over 3 per cent in per capita GDP.

40. Regional GDP is expected to continue to expand despite the global economic slowdown, thanks to a healthy internal macroeconomic situation and the impact of continuing growth on domestic demand. This is a highly auspicious set of conditions for the Latin American and Caribbean region, which has been afflicted more seriously than any other by an extreme degree of macroeconomic volatility that has, in the past, inhibited investment and undermined the ability of the countries in the region to achieve sustained growth. Meanwhile, current-account trends indicate that the region will maintain relatively high growth rates, with no strong external sector tensions on the horizon.

41. Nevertheless, many factors bear careful watching both from the standpoint of short-term macroeconomic policy and in view of the need for a more clearly delineated development strategy. In particular, beyond reaping the benefits of current international market conditions, the region needs mechanisms to sustain its

external competitiveness and to consolidate efforts by countries to develop policies and instruments that can keep fiscal accounts sustainable and strengthen their potential to counteract business cycle fluctuations.

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Summary of the survey of economic and social developments in the Economic and Social Commission for Western Asia region, 2006-2007

Summary

For the Economic and Social Commission for Western Asia (ESCWA) region, 2006-2007 marked another period of robust economic expansion in the region, with the exception of Iraq, Lebanon and Palestine, where regional conflicts and political instabilities reduced significantly the economic potential of those ESCWA members. The recent favourable external economic condition, represented by high oil prices, continued to buoy the region. While a deceleration of the gross domestic product (GDP) growth rate was observed, the level of growth was still high in most ESCWA member countries in 2006. Average GDP growth for the ESCWA region was an estimated 5.6 per cent for 2006, down from 6.9 per cent in 2005, which is forecast to decrease to 5.1 per cent in 2007.

In the two decades between the first and the current oil boom, the region exhibited negative average real per capita growth rates, rising unemployment rates and a growing gap in income distribution within and across the countries of the region. With lower oil rents, the rate of funding to the social infrastructure retreated, causing, in one instance, the quality of education to decline. Additionally, investment rates fell to a low 16 per cent in 2002, and productivity per worker was on average somewhere between steady and declining, while intraregional trade remained low, between 7 and 8 per cent. On the whole, however, the ESCWA region experienced excess savings, with extra funds continuously channelled abroad for reasons of low absorptive capacity or for regional security considerations. While this second oil boom represents a welcome occurrence to entrench the welfare gains of high growth,

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it comes with rising regional tensions. That translates into a pervasive threat of conflict that could add to the stresses of national institutions, which represent the very institutions that are charged with the process of development. There is a pressing need to enable the national agencies for development to avert the long- and short-term effects of the "resource curse", whereby the abundance of natural resources undermines overall economic performance and the competitiveness of the tradable sector, and the effects of "Dutch disease".

The theme of the Survey this year is to draw lessons from the previous oil boom and to search for policy alternatives capable of retaining financial and human resources in order to meet the requisites of development as a human right and to achieve the Millennium Development Goals.

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I. Recent economic trends and developments in the Economic and Social Commission for Western Asia region

A. The global context

1. The world economy continued its expansionary track in 2006, albeit at a decelerating rate of growth towards the end of the year. Current growth was broad-based and seen as being positive for both developed and developing economies, though its linkage to employment creation has still been weak. Robust demand growth continued to enhance the stable growth in the world flows of goods, services and capital. Moreover, institutional reforms in developing countries have helped to support the level of world demand.

2. The growth of global liquidity, which had peaked in early 2004, bounced back in early 2006. Despite the monetary tightening trend by central banks in developed countries, a continuous rise in world commodity prices created an ample cushion in the world expansion of credit. The narrowed spread between policy interest rates and long-term bonds was observed in most developed countries and some developing countries. The global imbalance, represented by the expanding current account deficit of the United States of America, has continued to be supported by strong demand for the financial assets of that country. The demand for United States treasury bonds grew in China and in the oil-exporting countries.

3. More signs of inflationary pressure emerged in 2006. For some countries, it was comparatively benign, with the first-round effects of higher commodity prices, particularly of oil products. However, the general hike in commodity prices caused a moderate increase in the price of basic food stuffs. Moreover, some developing countries saw a rapid expansion of domestic demand, with home-grown inflation stemming from the rapid rise in housing prices and corresponding rents.

4. In that global context, the ESCWA region marked another year of robust economic expansion, with the exception of Iraq, Lebanon and Palestine, where regional conflicts and political instabilities reduced significantly the economic potential of those ESCWA members.* The recent favourable external economic condition, represented by ample global monetary liquidity and high oil prices, continued to have an effect on the region. Specifically, this set of external factors, together with various efforts of intraregional cooperation, helped to minimize adverse effects and consequences of conflicts and political instabilities that would otherwise have been more devastating to the region, increasing its vulnerability.

B. Oil sector development

5. The world demand for crude oil continued to grow in 2006, albeit at a more moderate rate than in 2005. The rebound in the growth rate was largely expected from strong demand growth from North America and China at the beginning of the year. However, the projection of demand growth was successively cut as a result of sustained weaker demand from North America and developed countries throughout

* The ESCWA region consists of two subregions, namely: (a) countries of the Gulf Cooperation Council: Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates; and (b) countries and territories categorized as more diversified economies: Egypt, Iraq, Jordan, Lebanon, the Syrian Arab Republic, Yemen and Palestine.

the year. High oil prices encouraged those developed countries to switch their fuel sources to natural gas. Moreover, while strong demand growth was observed in China and other developing countries, overall demand growth in crude oil was moderate in 2006.

6. Despite the weaker than expected growth in demand, crude oil prices stayed historically high. The crude oil price of the Organization of Petroleum Exporting Countries (OPEC) reference basket averaged $61.08 per barrel in 2006, compared to $50.64 in 2005. The tight supply-demand condition in fuel products remained, as the bottleneck in refinery capability stayed unresolved. Moreover, owing to ample global monetary liquidity, speculation caused a rapid price hike until the summer, which was followed by a rapid plunge towards the end of 2006. The OPEC reference basket is projected to average $55 per barrel in 2007.

7. The total world crude oil supply inched up to 84.7 million barrels per day in 2006, from 84.1 million barrels per day the previous year. That increase can be attributed to the production of non-OPEC oil producers. Having allowed its members to produce at maximum in the last quarter of 2005, OPEC shifted its policy to reduce the crude oil production of its members. Total OPEC crude oil production was 30.9 million barrels per day in 2006, compared to 31.1 million barrels per day the previous year.

8. Following that trend, the total crude oil production of ESCWA member countries declined slightly in 2006 from the level of 2005, to 19.4 million barrels per day. However, as oil prices stayed high, that resulted in an increase of 25.7 per cent in gross oil export revenues, to a total of $401 billion for the ESCWA region.

C. Output and demand

9. The growth of gross domestic product stabilized at the high end in both subregions that form ESCWA, namely the countries of the Gulf Cooperation Council (GCC) and the more diversified economies. While a deceleration of growth rate was observed, the level of growth was still high in most ESCWA member countries in 2006. Average GDP growth for the ESCWA region was an estimated 5.6 per cent in 2006, down from 6.9 per cent in 2005, and is forecast at 5.1 per cent for 2007.

10. Robust growth in domestic demand was observed in the region in 2006, with the exception of the conflict-stricken countries and territories of Iraq, Lebanon and Palestine. The feared negative wealth effect, stemming from violent adjustments in stock markets in the region in early 2006, has not yet been observed to a significant degree. Recent rapid increases in fiscal expenditures in most ESCWA member countries sustained domestic demand and offset factors that reduced business and consumer confidence.

11. On average, GDP growth in the countries of the Gulf Cooperation Council was estimated at 5.9 per cent in 2006, after registering 7.3 per cent in 2005. While crude oil production and exports were the key factor for economic growth in the Gulf Cooperation Council, the development of non-oil sectors contributed to stabilizing overall economic performance. The development of non-oil sectors has been crucial for resilient growth in domestic demand in those countries during the present oil boom. The financial services and construction sectors led the growth in non-oil

production, thereby creating more linkages among supply-demand structures of the economy. The development of those linkages was observed in most countries of the Gulf Cooperation Council, which contributed to stabilizing GDP growth rate in that subregion.

12. Average GDP growth in more diversified economies was an estimated 5.1 per cent in 2006, after registering 6.0 per cent in the previous year. The more diversified economies continue to remain well away from potential foreign exchange constraints that could otherwise hamper the growth of domestic demands. In Egypt and Jordan, strong confidence in business and consumption was also proved through faster recoveries in stock market performance. The industrial sector has been developing at a constant pace, mainly in the apparel sector in Egypt and Jordan. The construction sector was strong in that subregion, reflecting high inflows of foreign capital as well as an increase in fiscal capital expenditures.

13. The trend was not shared by the conflict-stricken countries and territories of Iraq, Lebanon and Palestine, where security pressures caused business and consumer confidence to decline. The weak prospect for demand growth will move GDP growth projections into a lower range. While additional economic activities related to reconstruction efforts were expected, their contribution to overall GDP growth is expected to be limited in those ESCWA members in 2007.

Economies of the ESCWA region: rates of economic growth and inflation, 2003-2007

(Annual percentage change)

	Real GDP growth[a]					*Inflation rate*[b]				
Country/area	*2003*	*2004*	*2005*	*2006*[c]	*2007*[d]	*2003*	*2004*	*2005*	*2006*[c]	*2007*[d]
Bahrain	7.2	5.6	7.8	6.1	5.5	1.6	2.4	2.6	2.0	3.0
Kuwait	16.5	10.5	10.0	6.5	4.9	1.0	1.3	4.1	3.6	3.0
Oman	2.0	5.4	5.8	6.4	5.1	0.2	0.4	1.2	3.1	2.0
Qatar	3.5	20.8	6.1	7.0	7.4	2.3	6.8	8.8	11.1	8.0
Saudi Arabia	7.7	5.3	6.6	4.2	3.8	0.6	0.3	0.7	2.3	1.0
United Arab Emirates	11.9	9.7	8.2	8.9	6.0	3.1	5.0	6.2	7.7	5.0
Gulf Cooperation Council countries	**8.9**	**7.7**	**7.3**	**5.9**	**4.8**	**1.3**	**1.9**	**2.9**	**4.2**	**2.7**
Egypt	4.1	4.5	6.8	6.8	5.8	4.2	16.5	4.8	7.7	6.2
Iraq[e]	-33.1	23.0	10.0	8.0	7.0	33.6	27.0	37.0	53.2	66.4
Jordan	4.2	8.4	7.2	6.4	5.3	1.6	3.4	3.5	6.3	5.7
Lebanon	3.0	5.0	0.0	-5.0	6.0	3.0	1.7	-2.6	4.5	3.0
Syrian Arab Republic	1.1	8.6	4.5	5.0	5.6	4.8	4.6	7.9	10.0	14.4
Yemen	3.8	3.9	4.6	4.2	4.3	10.8	12.5	11.8	15.5	13.1
Palestine	8.5	2.0	4.9	-6.9	1.0	4.4	3.1	3.5	3.8	1.8
More diversified economies	**-0.2**	**6.4**	**6.0**	**5.2**	**5.7**	**6.5**	**13.3**	**7.5**	**12.0**	**12.5**
Total ESCWA region	**5.7**	**7.3**	**6.9**	**5.6**	**5.1**	**3.0**	**5.6**	**4.4**	**6.7**	**5.9**

Country/area	Real GDP growth[a]					Inflation rate[a]				
	2003	2004	2005	2006[c]	2007[b]	2003	2004	2005	2006[c]	2007[b]
Conflict-affected economies[d]	-13.9	11.4	4.6	0.4	6.0	14.6	12.2	15.2	26.9	32.9
ESCWA region except conflict-affected economies	7.4	7.0	7.0	6.0	5.0	2.2	5.1	3.7	5.4	4.1

Source: Economic and Social Commission for Western Asia, based on computations of growth rates from real GDP figures at constant 2000 prices. The latter are taken from national sources and from official figures as provided in responses to questionnaires in *National Accounts Studies of the ESCWA Region*, No. 26.

[a] ESCWA estimates, February 2007.

[b] ESCWA projections, February 2007.

[c] Iraq rates are based on official sources except for 2005 and 2006, which are ESCWA estimates.

[d] The average of Iraq, Lebanon and Palestine.

[e] 2006 estimates are based on official preliminary figures.

[f] International Monetary Fund, *World Economic Outlook* database, September 2006.

[g] Data for country groups are weighted averages, where weights for each year are based on GDP in 2000 constant prices.

D. Costs and prices

14. The increase in the general price level accelerated in 2006. The average inflation rate for the ESCWA region stood at 6.7 per cent in 2006, representing an increase from 4.4 per cent in 2005. High international commodity prices raised the general price level of the region. The items affected included crude oil, metal, construction materials and crops. Despite the modest contribution of those items to the cost of living in 2006, the price increases in those basic items had a significant impact on poorer segments of society in the region. Moreover, prices for rented accommodations increased significantly in some GCC countries. While the increase in rental prices reflected partly a demand in respective domestic economies that had grown excessively, it also reflected such non-economic factors as the legal structures concerning the ownership of accommodations.

15. Iraq continued to suffer from a high inflation rate, which was estimated at 53.2 per cent in 2006. The shortage of goods and services under severe security pressures, the changes in the price system and international factors contributed to the high inflation rate of that country, despite sound monetary and fiscal policies. Other conflict-stricken ESCWA members, namely, Lebanon and Palestine, experienced a moderate inflation rate, despite severe supply shortages during the conflicts in 2006.

E. Labour markets

16. Despite the overall continued economic growth, unemployment and underemployment remained the major socio-economic issues of the ESCWA region. Youth unemployment remained a major challenge for policymakers in the region, with persistent difficulties facing new entrants to labour markets as well as older female workers.

17. In Iraq, where the estimation of unemployment was exceptionally high, the acceleration of emigration and outflows of the skilled labour force became a major

concern. To a lesser degree, the same phenomenon was observed in Lebanon after the war in the summer in that country. Security pressure caused a reallocation of human capital and a potential for uneven development in the region.

18. Reform measures were in process, particularly among countries of the Gulf Cooperation Council. Diversity in measures and flexibility in operations have been observed in workforce nationalization strategies. Moreover, those strategies placed a greater emphasis on human resource development and vocational training of nationals. Within that context, a minimum wage for nationals working in the private sector was established in Bahrain and the United Arab Emirates; and Saudi Arabia exercised a flexible decision on required quota rates of the employment of nationals by cutting the quota rate temporarily for sectors where there was a shortage of qualified labour. Additionally, Bahrain, Kuwait and the United Arab Emirates have been drafting and reviewing new labour laws for adoption in the near future.

19. In 2006, there was greater focus on the issue of rights for foreign workers in the region, particularly in the countries of the Gulf Cooperation Council, within the framework of labour law reforms. Specifically, the United Arab Emirates could introduce new standard contracts aimed at regulating the rights and duties of foreign housemaids in early 2007. Jordan enhanced labour inspections, especially to protect foreign workers in its qualified industrial zones, and decided to raise the minimum wage for both nationals and foreign workers in 2006.

F. External sector

20. The external sector performance of the ESCWA region was robust in 2006. It was observed that there was a positive current account balance in most member countries, while trade activities of the region continued to expand. This could be attributed to the strong export performance of oil-exporting ESCWA member countries, several crucial developments in industrial exports and robust service trade represented by tourism. While Jordan, Lebanon and Palestine experienced current account deficits in 2006, the level of deficits declined in all three ESCWA members in terms of GDP. Egypt, the Syrian Arab Republic and Yemen registered a positive and robust current account surplus, and the GCC countries recorded a historically high current account surplus.

21. In respect of the United States-Middle East Free Trade Area, the United States was active at various stages of trade negotiations in the ESCWA region. In January 2006, a free trade agreement was signed between Oman and the United States; a free trade agreement between Bahrain and the United States entered into effect in August of that year; and the United Arab Emirates was at the negotiation stage to establish a free trade agreement with the United States. In parallel to those developments and within the framework of the Euro-Mediterranean Partnership, the Agadir Agreement between Egypt, Jordan, Morocco and Tunisia came into effect in 2006, aimed at establishing a free trade agreement between the four Arab Mediterranean countries with benefits of preferential access to European Union markets. The Gulf Cooperation Council was actively engaged in trade negotiations with its important trading partners and held several rounds of negotiations with the European Union to establish a free trade agreement. The Gulf Cooperation Council also considered setting up such agreements with China, India and Singapore.

G. Economic policy developments

22. With the exception of the conflict-stricken economies of Iraq, Lebanon and Palestine, the high oil revenues in the GCC countries and the robust economic performance of the more diversified economies enabled the Governments in the region to form active fiscal expenditure policies for their fiscal year covering 2006. An increase in Government expenditure in the health and education sectors was observed to be a priority in most of the countries. Moreover, the priority attached to economic diversification efforts was also reflected in the initiation of urban development projects, particularly in the countries of the Gulf Cooperation Council. Despite the significant increase in Government expenditure, ESCWA member countries maintained their prudent fiscal policy stance. The oil price projections for revenue estimation were very conservative in the national budgets of the GCC countries. Egypt and Jordan successfully met their targets in reducing budget deficits and public debt. While development needs spurred Government expenditure in Yemen, it was executed on the basis of increased oil revenue and stable international assistance.

23. In the conflict-stricken countries and territories of Iraq, Lebanon and Palestine, fiscal policies were subject to security pressures and to uncertain political situations. The largest budget to date was prepared for Iraq for 2006, stressing reconstruction and investment projects. However, the implementation of those projects was hampered by security situations. In Lebanon, the aftermath of the war of Israel in the summer of 2006 placed severe constraints on fiscal policy. International support was pledged in August 2006 for reconstruction and in January 2007 for a comprehensive development plan, in line with the reduction of its external public debt. In 2006, Palestine lost fiscal control when Israel withheld tax revenues that were collected on behalf of the Palestinian Authority. With the suspension of development aid to Palestine from developed countries since January 2006, the institutional base for conducting fiscal policy has been severely weakened.

24. In 2006, inflation became increasingly a major policy agenda in the region as trends in consumer prices moved visibly upwards. Under pegged or well-targeted stable exchange rate regimes, central banks in the ESCWA region were active in controlling domestic liquidity. However, the effect was limited in forcing price levels, as the inflation stemmed from the increase in international prices for commodities, including construction materials, and from the rapid growth in domestic demand. Moreover, given the expansionary stance of fiscal policy, it proved difficult for monetary policy alone to control selectively the level of domestic demand. However, with the exception of Iraq, inflation rates in the ESCWA region were still in a manageable range, albeit at different levels.

25. In order to alleviate an extremely high inflation rate, the Central Bank of Iraq revaluation of the national currency has occurred continuously since November 2006 so that import prices would decline in terms of national currency. In the two months prior to the end of 2006, the Iraqi dinar appreciated against the United States dollar by 12 per cent. The Central Bank of Kuwait raised the value of its national currency against the dollar by 1 per cent in order to quell inflation pressures that stemmed from the depreciation of the dollar against other major currencies. While other central banks of the Gulf Cooperation Council countries did not follow this move, policy discussions on the exchange rates of those countries, which are pegged to the dollar, intensified in 2006, particularly in the light of the imminent Gulf

Cooperation Council monetary union that planned for 2010. Moreover, Oman announced in December 2006 its decision not to join the Monetary Union by 2010, which stirred discussions over processes and schedules for the single currency of the Gulf Cooperation Council.

H. Prospects

26. The present oil-boom cycle is expected to end in 2007 as oil prices begin to decline. However, the ESCWA region is projected to grow at 5.1 per cent in real GDP. Government economic policies, both fiscal and monetary, will sustain domestic demand in countries where consumer and business confidence indicated no sign of weakening, with the exception of the conflict-stricken countries and territories of Iraq, Lebanon and Palestine. The inflation rate in the region is expected to be contained at current levels and to turn into a gradual reduction in the cost of living.

27. A worrisome economic factor for the region is a worldwide credit crunch where the growth of global monetary liquidity stalls. With less inflows of capital, the more diversified economies may face foreign exchange ceilings on domestic demand growth, which could cause severe macroeconomic imbalances and possibly inflation. While the countries of the Gulf Cooperation Council are not expected to face foreign exchange ceilings even if those circumstances are present in the world economy, such ceilings could damage the strongly emerging financial sector of the subregion. Despite a low probability of such a worldwide credit crunch occurring in 2007, there is a need to recognize the potential vulnerability of the region.

28. Policy discussions on institutional developments and arrangements concerning regional economic cooperation will be intensified in 2007. The outcome of such discussions, particularly those concerning the Gulf Cooperation Council monetary union, will be crucial for the ESCWA region and for the international financial architecture. Moreover, labour market reforms will increasingly be on the agenda in relation to trade negotiations for free trade agreements with trading partners of developed countries. Such reforms influence national human resource development as well as the distribution of human capital within the ESCWA region.

II. Lessons from the previous oil boom

A. The issues

29. The current oil boom affects ESCWA members in very different ways. Given the persistence of relatively high oil prices, the region will continue to enjoy higher than average growth rates. However, falling oil prices and their impact on welfare are of major concern. The *Survey of Economic and Social Developments in the ESCWA Region, 2006-2007* examines the monetary and financial policy implications of the boom for countries or areas in different contexts, especially the Gulf Cooperation Council and more diversified economies. It also looks at how, when they are available, those resources can be deployed in order to foster the achievement of lasting pro-poor and rights-based goals. The specific focus of the *Survey* is the interaction between monetary, financial, fiscal and distributive policies in the ESCWA member countries and areas under conditions of oil boom. The work

aims to identify policy options for specific country groups within ESCWA and the institutional means to achieve the desired objectives under the concrete circumstances of the ESCWA members.

30. Managing the boom hinges on the outcome of Government policy decisions and on the adequacy of those policies. While the "resource curse" could plague natural resource-rich countries in the long run, the "Dutch disease" is believed to affect those countries in the short run, when export markets are exceptionally favourable. The inflow of foreign exchange resulting from the oil boom is thought to trigger a range of adverse economic outcomes, including inflation and deindustrialization. The latter partially occurred in the case of the nascent industries of the more diversified economies, while oil rents may have favoured industrial developments in the GCC countries. The ESCWA region has been subjected to elements from both types of negative externalities. However, none of those issues is inevitable or unavoidable given the right policy mix, and the possibility exists for making durable welfare gains.

31. The resource boom manifested itself initially through the improvement of the national balance of payments. That improvement enabled the regional and national economies to command additional resources in the world economy, including imports, investments abroad and remittances to other parts of the world, at no immediate or apparent cost to themselves. In such circumstances, additional spending in domestic currency becomes possible once a portion of the new foreign currency inflows has been internalized and exchanged for local currency. Through such diverse channels, the extraordinary currency inflows tend to induce a higher level of activity in the domestic economy, which in turn, and in some cases, can trigger the real appreciation of the currency. That appreciation can become a source of difficulty for the economy if it hinders export diversification or erodes the competitiveness of traditional areas of activity. It can also increase the structural fragility of the balance of payments or reduce the ability of the economy to cope with adverse shifts in resource inflows. In the ESCWA region, economic diversification has been sluggish.

32. In some member countries, the impact of the real appreciation of the currency was felt in two sectors, namely: (a) the non-tradable sector, including retail trade, most services, construction and many staple foods, which tends to expand as it benefits from demand growth and can pass on to consumers the impact of any cost increase; and (b) the non-booming tradable sector, which tends to contract following a resource boom given its exposure to foreign competition in the context of a rising real exchange rate. This process of adjustment is known as Dutch disease. Given that the non-booming tradable sector tends to be associated with manufacturing industry, natural resource booms have often been associated with deindustrialization, which was not the case in the GCC countries. However, higher inflows into the more diversified economies, in combination with what sometimes seemed to be an eagerness for trade liberalization, adversely affected some of them. In the ESCWA region, the economy increasingly depends on the booming sector as the non-booming tradable sector contracts gradually. As a result, it is even harder to counteract the effects of Dutch disease and limit the drift towards economic specialization and, consequently, volatility, which can also harm the economy and contribute to the reduction in investment rates.

33. Left unattended, the long-term growth consequences of Dutch disease can be severe. At the very least, it has been argued that it can create rich countries with poor people. By contrast, a diversified economic base (including manufacturing and services production for domestic consumption and for export) generally involves a more refined division of labour and higher levels of employment. Additionally, it can lead to increasing returns and stronger externalities, which can more easily support a rights-based and pro-poor development strategy, in line with the above-mentioned development objectives of the *Survey*.

34. The case could be made that Dutch disease and the resource curse are not the only explanations for the weak macroeconomic performance in between oil booms in most ESCWA members. Tensions between the transformative demands of economic development and the conservative impact of traditional social structures, which are supported by the capture of export rents, have also triggered negative externalities in many countries. Moreover, the extraordinary prosperity of the oil economies in the 1970s and early 1980s, in the context of strong geopolitical conflicts in the ESCWA region, generated widespread social tensions. In the more diversified economies, economic modernization has also generated standard tensions associated with processes of rapid growth. However, conditions in the more diversified economies are complicated to some extent by the fact that those economies are heavily affected by the circumstances in their oil-rich neighbours, as well as by geopolitical concerns in the Middle East. Such tensions and displacements explain why the ESCWA region exhibits potentially high long-term economic risks and high inequality, especially in the oil-rich countries.

B. Transmission mechanisms

35. The *Survey* notes that certain inter-boom period shortcomings in ESCWA members can be attributed only partly to the resource curse and Dutch disease. Neither the rich oil countries with small populations nor the poorer and relatively more populated non-oil producing countries and areas in the ESCWA region have been able to internalize the complex chains of economic activities that could have permitted their sustained and autonomous economic development. In addition, the nature of social cohesion and the concentration of income and wealth tend to favour predatory accumulation strategies, in which export gains are mostly retained by a small section of the population and, subsequently, transferred abroad either directly or through the State. In this case, resource revenues could be used to alleviate pent-up social tensions, while a large part of the net resource inflows (plus external loans secured on future export income) could be misallocated by financing distorted or socially undesirable policies and projects. Such outcomes are more likely in unequal and conflictive societies, which is often the case in the ESCWA region. In order to avoid those adverse outcomes, it is important to look beyond the availability of natural resources and focus on institution-building, democratization of the State and the design of consistent, socially legitimate and ambitious industrial policies.

36. The macroeconomic outcome of windfalls is heavily dependent on the objectives and policy choices of individual ESCWA members. It is largely within the power of policymakers to decide whether there will be Dutch disease, as well as its extent and consequences, given that they can avoid its effects by implementing coordinated and purposeful fiscal, monetary, financial and exchange rate policies. In

that sense, Dutch disease is both avoidable and a policy outcome; it is the unintended consequence of Government policy choices and private sector behaviour.

C. Policy guidelines

37. In order to avoid the effects of Dutch disease, individual ESCWA members need to coordinate monetary, exchange rate and fiscal policies. In that effort, direct exchange rate management is key to success, given the limited ability of monetary instruments to manage the exchange rate indirectly. Financial markets are underdeveloped in the ESCWA region, which implies a narrow and limited market for Government paper, the buying and selling of which is the mechanism by which the exchange rate is indirectly managed. In the absence of effective monetary mechanisms for exchange rate management, avoiding the effects of Dutch disease implies managing a pegged exchange rate, which is the case for all oil-producing countries in the ESCWA region.

38. Fixed or pegged exchange rates are sometimes subject to the so-called "impossible trinity", which refers to the combination of a liberalized capital market, a fixed exchange rate and effective monetary policy. According to that logic, if a capital market is liberalized, the domestic interest rate must be used to maintain the fixed exchange rate by balancing a trade deficit with capital inflows. This implies that the interest rate cannot also be used to manage the money supply. The logic is of limited relevance to the ESCWA region for several reasons. First, given that financial markets are underdeveloped, the buying and selling of Government paper is not an effective policy instrument, whether the exchange rate is fixed or flexible. Secondly, "impossibility" is based on the assumption that external capital flows are perfectly elastic with respect to the margin between the external and domestic rates of interest. The same underdevelopment of financial markets that makes open-market operations ineffective implies that capital flows are not perfectly elastic in the ESCWA region. Thirdly, there are many degrees of capital account liberalization and regulation such that the alternatives are not a "free" and a "closed" capital account. Finally, the accumulation of foreign exchange reserves arising from an oil price boom can be separated from the domestic economy through a number of mechanisms that do not require open-market operations. One such mechanism is an oil fund, which has been established by many oil-producing countries.

39. Adopting a fixed or pegged exchange rate, as is the case of oil-producing countries in the ESCWA region, represents an already effective way to prevent the nominal appreciations that can undermine the competitiveness of non-oil tradables. Furthermore, there is no economic justification for a flexible exchange rate given that it does not facilitate an effective monetary policy. The primary function of exchange rate flexibility is its role in stabilizing the short-term balance of payments and allocating resources in the long term. Given that the exports of oil-producing countries are not determined by domestic prices, the exchange rate plays no significant short-term adjustment role. While it can affect the allocation of resources in the long run, this is an argument against flexibility arising from Dutch disease. Within that context, the role of monetary policy is one in which the domestic interest rate is used to prevent inflationary pressures or, in the absence of such pressures, to facilitate credit to the private sector. It is on the latter issue that ESCWA members are advised to focus.

40. Fiscal policy in the ESCWA region must have four objectives in order to avoid symptoms of Dutch disease, as follows: (a) to reduce the variability of growth (the short-term countercyclical function); (b) to raise the growth rate (the long-term supply function); (c) to affect the composition of growth by economic activity; and (d) to make growth more equitable. It is relevant in this context to re-emphasize, as suggested in the *Survey of Economic and Social Developments in the Economic and Social Commission for Western Asia Region, 2005-2006*, that presumptive taxes on income and short-term capital gains are preferable to a heavy reliance on indirect taxes. While indirect taxes are generally less income-elastic than direct ones in the ESCWA region, they do not represent a serious constraint on the accounting side. Moreover, the stabilizing function need not be carried out on the revenue side, particularly in oil-exporting countries. Creating an oil fund, for example, allows a Government to set aside petroleum revenues when international prices are high (and the economy is expanding), and to use that reserve when prices fall in order to offset recessionary conditions. However, the purpose of progressive taxation is not simply a matter of accounting; rather it is to introduce fiscal reforms that can also provide feedback into institutional reform, thereby encouraging development in all sections of society.

41. The appropriate policy combination to avoid Dutch disease and the instability associated with a volatile international market for petroleum is as follows: (a) a fixed or pegged exchange rate managed to make non-oil tradables competitive, with a preference for a basket of currencies to reflect the trade shares of the concerned country; (b) an accommodating monetary policy, with objectives consistent with its limited effectiveness; and (c) an active fiscal policy that maintains the economy near its non-oil potential in the short run and reduces supply constraints faced by the tradable sectors. In that light, Governments are advised to proceed cautiously with trade liberalization, given that transitory effects of Dutch disease could undermine the competitiveness of the non-oil tradable sectors.

42. On the investment side, countries in the region are advised to avoid a repetition of the inter-boom period, namely, a cycle that began in the late 1980s with low oil prices, followed by poor investment performance. The private investment promotion arrangements of the inter-boom period were not sufficient to raise growth because they did not deal with risk and market-size issues, despite providing the partial and, to varying degrees, the institutional framework as well as guarantees on repatriation. Moreover, those policies were built on the implicit understanding that the private and the public sector competed for the same resources. Experience has shown that they do not; indeed, there is plenty of slack in the economy for both sectors to use in a complementary fashion. Consequently, an initial capital injection is required so that public and private investments rise simultaneously and set the economy on a new growth footing. However, as a precursor to that, the risk to long-term private investments must be minimized, and public investment must be made accountable and efficient. Market size and economic integration provide the impetus for investment and the ensuing returns. The undercurrent of political risk, from which long-term private investments require protection, remains linked to the shape of regional security arrangements and the capacity, implicit or explicit, of the public sector to provide a quasi-insurance scheme for local or foreign investors.

43. Public investment could be a central aspect of an active fiscal policy, which is particularly important for petroleum-exporting countries. Unless managed carefully and designed appropriately, public expenditure can be the major cause of Dutch

disease. The expenditure of large revenues from oil needs to be managed in line with the following two basic guidelines:

(a) The absolute level of revenues needs to be consistent with robust growth and macroeconomic stability. Achieving the appropriate level of expenditure is an issue of aggregate demand management. An oil fund is the mechanism aimed at achieving this demand management, accumulating funds when revenue flows are high and releasing funds when flows are low, preferably with infrastructure investment on the regional level being a priority;

(b) The distribution of public expenditure between consumption and investment is crucial to overcoming the effects of Dutch disease. The vast majority of public expenditures are for non-traded goods and services. As a result, public expenditure, by raising the demand for such goods and services, tends to increase their prices and exacerbate pressures towards real exchange rate appreciation. Little can be done to overcome that tendency in the short term, which increases the need for direct exchange rate management. In the long term, careful design of public expenditure can mitigate the effects of Dutch disease by reducing the cost of tradable goods and services. Outlays on education and health can achieve this to some degree by raising the productivity and skills of the labour force. However, the extent to which such outlays can be targeted for their productivity-increasing effect is conditioned by the commitment to provide these services for the entire population.

44. The objective here is to minimize the negative impact of short-term fluctuations resulting from abrupt capital flows and low oil-price shocks and to maximize the long-term contribution of technology and other knowledge-based factors to growth. The latter outcome alone is in itself a buffer against erratic capital or price movement. However, in the initial stages, this requires steady investments in research and development, human capital and the institutional framework that are independent of movements in capital flows and oil-price fluctuations. Such investment flows could create the sort of public/private partnership that can increase long-term private sector competitiveness and public sector efficiency. Moreover, there is empirical evidence to suggest that investments of that sort tend to exhibit much higher returns than purely physical investments. However, such a scenario also requires a higher level of regional integration and an investment and growth stabilizing fund. In short, a regional stabilization fund requires regional cooperation. Calls for integration in the past, which were based on the supposed benefits of integrating oil-producing countries with non-oil producing countries, have made little progress. Rather, it appears that as a result of increasing common geopolitical concerns and capital mobility, measures towards cooperation were undertaken not so much to reap the benefits of integration as to prevent the common woe of collapse resulting from geopolitical considerations. In fact, recent trends indicate that currency stabilization measures in the region were carried out on various bilateral levels in what amounts to de facto monetary cooperation. This needs to be taken one step further by expanding or instituting a de facto Arab monetary cooperation framework.

45. Much greater scope exists to use public investment to foster the non-oil tradable sectors. By definition, construction itself is a non-traded activity. However, the provision of infrastructure can be targeted to cost reduction for the tradable sectors. An obvious example is transport infrastructure that lowers costs for

exporters. Other examples are improvements in communications, including Internet services, and the creation of public or private sector institutions for research and development.

46. An emphasis on public investment rather than on current expenditure could reduce the danger of "crowding out" private investment caused by a public budget that is buoyed by oil revenues. There are two aspects of crowding out, namely, the aggregate expenditure aspect and the complementarities aspect. Public investment tends to crowd out private investment when an economy is near full employment and when public investment projects are those that the private sector could also carry out. When there are unused resources, there is economic space for an increase in all types of expenditure, both public and private. In addition, if public sector investment projects complement private sector investments, the former can stimulate the latter ("crowd in"). As a final observation on crowding out in the ESCWA region, a substantial part of private sector investment either does not borrow for investment, or does not do so in the financial markets that would be affected by Government borrowing. Investment by small rural and urban producers is often self-financed or financed from indigenous lenders with little connection to the formal banking system. In addition, foreign investment in the non-oil sectors, to the extent that it is important in individual countries, is not typically financed from domestic financial markets.

47. Finally, Governments and central banks can modulate the potentially adverse impact of windfalls by using fiscal, monetary and exchange rate policy tools, as well as capital controls and balance of payments management techniques. Moreover, they can use industrial policy tools to direct the resource inflows, thereby allowing Governments to address strategic economic needs and capacity bottlenecks. Adequate policy tools can help to transform the windfall into sustained growth or, at least, to avoid the destructive threat of Dutch disease.